

GUIDE ON THE NEW RULES
GOVERNING THE FUNDING OF
RESEARCH BY INVESTMENT SERVICE
PROVIDERS UNDER MIFID II
January 2018



PREAMBLE

□ Regulatory context and general purpose of the reform

The funding of research is now governed by the Markets in Financial Instruments Directive (MiFID II)¹ and the Delegated Directive of 7 April 2016² in order to protect investors and limit the risks of conflicts of interest and thus restricts, or even prohibits, investment service providers ("ISPs")³ from receiving or paying inducements.

Indeed, MiFID II considers that the provision of research constitutes for the recipient a form of inducement, i.e., a benefit, in the broadest sense, which carries potential conflicts of interest. To receive any form of inducement is now prohibited for firms providing portfolio management services on behalf of third parties (i.e., discretionary management) or investment advice on an independent basis. In addition, Article 13 of the Delegated Directive details the manner in which inducement rules should apply in the particular case of the provision of research by third parties to ISPs.

More specifically, Article 13 now requires the funding of research through one of the following two methods:

- direct payment for research using the ISP's own resources; or
- payment charged to the ISP's clients from a separate research payment account that is controlled by the ISP, under certain operational and transparency conditions.

This is a major innovation since the provision of research has never been treated as a form of benefit or incentive. However, access to quality and diversified research is an essential tool for a portfolio manager, in particular an active portfolio manager, as a guide to possible investment choices. The provisions of MiFID II will therefore fundamentally change the funding of research and call into question a large number of existing models, for two reasons mainly, related to a broad scope of application covering all financial instruments and the establishment of a new mechanism for the reception of fees for research services.

AMF consultation

In this context, the AMF launched a consultation for professionals in the autumn of 2016. The main objective of this consultation was to propose ISPs – in particular those offering third-party portfolio management services – a means of interpreting this new regulation to enable them to draw conclusions for their daily activities.

It should be reminded that this consultation, which was limited to the funding of equity research, also contained a call for comments on its application to the credit market.

Feedback from the consultation

The feedback from the consultation, to which French and European professional associations widely contributed,⁴ was subsequently published on 10 February 2017. This document provides a summary of the observations and proposals conveyed by the respondents, while providing as much clarification as possible with respect to the many practical questions raised by a number of them.

¹ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

² Commission Delegated Directive of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.

³ The texts cited are aimed directly at investment firms, but these provisions also apply to credit institutions pursuant to Article 1 (3) b) of MiFID II when they provide one or more investment services and/or carry out investment activities, and to asset management companies for the provision of investment services in accordance with Articles 6 (6) of the AIF Directive and 6 (4) of the UCITS IV Directive.

⁴ The AMF received 44 responses from all types of stakeholder, of which more than a quarter were abroad: mostly on the buy side in the broadest sense of the term (18) and sell side (8), as well as from independent analysts and data providers.

ESMA's Questions and Answers publications

In parallel with this consultation, the AMF actively participated in Level 3 discussions at the European Securities and Markets Authority ("ESMA") in order to achieve a convergent and harmonised application of the new rules on the funding of research at a European level.

Since October 2016, ESMA has published a number of Questions and Answers ("Q&A") documents⁵ on research-related inducements, the latest update of which is dated 6 June 2017. Eleven Q&A documents are currently available.

□ Timetable for regulatory transposition

Article 13 of the Delegated Directive is incorporated into French positive law within the **AMF General Regulation ("AMFGR")**. These new rules will apply from **3 January 2018**, the date of entry into force of the provisions transposing the Delegated Directive.

The drafting of the amendments to the AMFGR was the subject of a **public consultation which ended on 10 June 2017**⁶.

□ Objectives of the guide

The publication of this guide is a follow-up to the AMF's consultation on the new rules governing the funding of research published on 10 February and the public consultation on amendments to the General Regulation following transposition of the provisions of the Delegated Directive, as well as the finalisation of the Level 3 work at ESMA in the form of questions and answers.

This guide has two objectives:

- supporting the players in the operational implementation of this reform which has led to an in-depth re-think of the current practices of funding research on equities and other financial instruments;
- proposing practical answers to the main issues identified, organised around seven major themes relating mainly to the definition of services or benefits that fall under the new research funding mechanism and to the constitution and operation of the research budget.

The guide has been written in such a way that each subject-matter section can be consulted independently.

□ Who does the guide target?

This consultation is aimed particularly at:

- Retail investors and their representatives;
- Investment service providers;
- Professional associations;
- Institutional investors;
- Non-investment service providers that provide financial analysis services, including independent analysts;
- Consumer associations; and
- Consultancy and legal firms, and particularly firms that work within the financial industry.

⁵ Questions and Answers on MiFID II and MiFIR investor protection topics, 7. Inducements (research)

⁶ AMF public consultation on amendments to be made to the General Regulation following the transposition of the provisions of Commission Delegation Directive 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU, known as "MiFID II".

□ **Texts referred to by the guide**

- **Directive 2014/65/EU** of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (“**MiFID II**”);
- **Commission Delegated Directive (EU) 2017/593 of 7 April 2016** supplementing Directive 2014/65/EU (“**Delegated Directive**”);
- **ESMA Questions and Answers** on investor protection issues in the framework of MiFID II and MiFIR⁷ (“**ESMA Q&A**”);
- **French Monetary and Financial Code** as amended following the entry into force of Ordinance No. 2016-827 of 23 June 2016 on markets in financial instruments⁸;
- **AMF General Regulation (“AMFGR”)** as amended following the transposition of the provisions of Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing MiFID II.

NOTE

This guide is not intended to list all the operational issues that only practice will reveal. Moreover, the content of this document is subject to change, in particular as a result of the clarifications made by ESMA as part of its work on Level 3.

As a result, this guide may be further updated and supplemented at a later stage.

⁷ “*Questions and Answers on MiFID II and MiFIR investor protection topics*”, the latest update of which, at the time of writing of this guide, dates to 6 June 2017.

⁸ This Ordinance comes into force on 3 January 2018, with the exception of Article L. 549-15-II of the Monetary and Financial Code, which enters into force on 3 September 2019.

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SECTION NO. 1: SCOPE OF APPLICATION OF THE FUNDING OF RESEARCH

MAIN REFERENCE TEXTS

Level 1	Directive 2014/65/EU: - Article 24 (7), (8), (9) - Annex 1 section A
Level 2	Delegated Directive (EU) 2017/593: Article 13 (1)
Level 3	ESMA Q&A No. 4: <i>Research from third-country providers</i> ESMA Q&A No. 5: <i>Research from another group entity</i>
Transposition into internal law	Monetary and Financial Code: Articles L. 533-12-2, L. 533-12-3 and L. 533-12-4

GENERAL PRINCIPLES

In accordance with the scope of MiFID II, these new provisions apply to investment service providers ("ISPs") that receive or use research as part of their investment services, namely:

- investment firms;
- credit institutions authorised to provide investment services;
- portfolio management companies, other than those with investment firm status, as part of their individual portfolio management or investment advice activities.⁹

The new research funding mechanism applies to **all types of research, on equities or other financial instruments such as bonds and derivatives**, used as part of investment services as defined by MiFID II.

Note that the Delegated Directive **does not provide for proportionality** in the application of provisions regarding the funding of financial analysis.

Terminology used in this guide:

For the sake of convenience and **exclusively** for the requirements of this guide, the abbreviations used should be understood in reference to the following definitions:

- "Research provider": this refers to any institution providing a financial analysis service including:**
 - independent research providers;
 - providers supplying research and execution services.
- "Research consumer" refers to ISPs, namely:**
 - credit institutions authorised to provide investment services;
 - investment firms ("IF"), including, in particular, **portfolio management companies that now have the status of an IF** when they solely provide a portfolio management service (discretionary management) and independent investment advice;

⁹ It should be noted that Article 12 of the Delegated Directive sets out the general framework of inducements relating to **independent investment advice** and **portfolio management services**. Article 13, which describes the conditions for the supply of research by third parties, applies to investment firms providing portfolio management **"or other investment or auxiliary services"** to clients.

- **portfolio management companies – other than those governed by IF status** – authorised to carry out collective management (UCITS or AIF) and individual management (discretionary management) when they offer both portfolio management and independent investment advice services¹⁰.

- **“Client”**: the end client of the “Research consumer”.

QUESTIONS – ANSWERS

1.1 Does the reform apply to research used for collective management?

No. In accordance with the scope of application of MiFID II, the new provisions related to research-related inducements apply solely to ISPs as part of their third-party portfolio management or independent investment advice activities.

Nevertheless, asset management companies that manage UCITS or AIFs are free to extend this mechanism to the consumption of research as part of their collective management activities providing that the holders of the collective investments are clearly informed in advance. The practical arrangements must comply with the specific provisions of UCITS and AIF regulations relating to client information.

In any case, research costs invoiced to clients managed under mandates should not fund the research used for the collective management activity and vice versa.

1.2 Is research on non-equity markets impacted by the reform?

Yes. The new mechanism for the funding of research applies when a research service meets the criteria of Recital 28 of the Delegated Directive¹¹. Under these conditions, it must be systematically assessed and paid separately.

The research consumer may fund credit research directly using its own resources or via a research budget funded by specific research costs invoiced to the client, the amount of which is fixed in advance for the research service¹².

1.3 Under what conditions may research consumers accept research supplied by third-country providers not subject to MiFID II?

Institutions subject to MiFID II rules on conflicts of interest and inducements must apply the new rules on the funding of research independently from the research provider’s geographical location¹³.

For example, a French asset management company providing an investment service as under MiFID II may decide, among other things, to consult third parties, including the third-country research provider supplying both research and execution services, with a view to determining the charge attributable to the research provided.

¹⁰ Pursuant to Article 6 of the Directive of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and Article 6 of the Directive of 8 June 2011 on Alternative Investment Fund Managers.

¹¹ See Section No. 2 below: “Definition of research”.

¹² **ESMA Q&A No. 9:** “ESMA notes that firms still have the option to pay for research themselves, or using a research payment account that is funded by a direct charge to the client, which could be facilitated by a third party such as a depositary or custodian, rather than alongside a transaction”.

¹³ **ESMA Q&A No. 4:** “Firms should therefore treat research from a third country provider in the same way as any other third party benefits”.

1.4 Can intra-group research be treated differently by the research consumer that receives it?

No. MiFID II rules on inducements, whether related to research or not, apply independently of the relationship between the research provider and the receiving institution.

These rules apply in the same way in an extra-European context. For example, a research service provided by a third-country subsidiary to an entity of the same group, established in the EU and subject to MiFID II provisions, will have to be invoiced independently if it is associated with another other types of services.

SECTION NO. 2: DEFINITION OF RESEARCH

MAIN REFERENCE TEXTS

Level 1	MiFID II: Article 24 (7), (8), (9)
Level 2	Delegated Directive (EU) 2017/593, Recital No. 28 sets out the two conditions that have to be met so that a document, service or any other benefit may be qualified as research.
Level 3	ESMA Q&A No. 9: <i>Research related to fixed-income, currencies or commodities</i> ESMA Q&A No. 10: <i>Budgeting, allocation of the research budget, determination and assessment of payments made from it</i>
Transposition into internal law	AMFGR: Article 314-21

GENERAL PRINCIPLES

The research consumer is responsible for verifying that the benefit it receives corresponds to the characteristics of the research defined in **Recital 28 of the Delegated Directive**, namely that:

- It concerns research material¹⁴ or services concerning one or several financial instruments or other assets, or the issuers or potential issuers of financial instruments, or be closely related to a specific industry or market such that it informs views on financial instruments, assets or issuers within that sector or market;
- This type of material or services explicitly or implicitly recommends or suggests an investment strategy and provides a substantiated opinion as to the present or future value or price of such instruments or assets, or contains analysis and original insights and reach conclusions based on new or existing information that could be used to inform an investment strategy and be relevant and capable of adding value to the research consumer's decisions on behalf of its clients.

It should be reminded that the proposed definition applies **only under the special mechanism for the funding of research provided for by MiFID II**. Consequently, the application of this definition is not intended to be extended to other European texts (for example, the Market Abuse Regulation).

QUESTIONS – ANSWERS

2.1 Who is responsible for assessing and deciding whether the document, service or any other benefit received constitutes research?

It is for each research consumer to carry out its own analysis of any document or service in order to assess and justify whether or not the latter constitute research within the meaning of the Delegated Directive.

¹⁴ Material means any form of documentation that is written or presented on a sustainable medium.

2.2 How should research consumers assess trade ideas issued by certain market intermediaries as part of their commercial relations?

It is up to each research consumer to assess whether or not this type of information meets the research definition criteria or that of a minor non-monetary benefit.

Note that Recital 29 of the Delegated Directive indicates that **non-substantive** material or services consisting of **short-term** market commentary on the latest economic statistics or company results, or information on upcoming releases or events, which is provided by a third party and contains only a brief summary of its own opinion on such information **that is not substantiated nor includes any substantive analysis**, can be deemed to be information of a scale and nature such so that it constitutes an acceptable minor non-monetary benefit.

2.3 May a note or publication that is not provided directly by a research department be qualified as “research”?

Yes. The qualification of “research” does not depend on the source issuing the note or the publication. It is up to each research consumer to assess whether or not this type of information corresponds to the criteria for the definition of research, as recalled above.

2.4 Is a note or publication whose disclaimer or header explicitly excludes the qualification of “research” necessarily disqualified as being “research”?

No. The qualification appended to the header (e.g. “this is not research” or “commercial documentation”) on a note or publication, or the source of that publication (“dealing desk” rather than research department)¹⁵, does not constitute a sufficient exclusion criterion¹⁶. The research consumer is therefore not exempted from its obligations to duly verify and assess the note or publication it receives.

2.5 Can recurring expenses linked to a subscription providing access to research documents be borne by the client via the research budget?

Yes. Recurring expenses linked to a subscription allowing access to research documents may be borne by the client via the research budget when the research consumer is able to justify this in terms of the added value this service brings to its investment decision and which benefits the end client. These costs must be allocated on the basis of a pre-determined policy that is made available to the client¹⁷.

¹⁵ Question 2.4.

¹⁶ ESMA Q&A No. 6.

¹⁷ Section No. 6.

SECTION NO. 3: MINOR NON-MONETARY BENEFITS

REFERENCE TEXTS

Level 1	Directive 2014/65/EU: Article 24 (7), (8), (9)
Level 2	<ul style="list-style-type: none"> • Positive definition: Delegated Directive: <ul style="list-style-type: none"> - Article 12 (3): <u>exhaustive</u> list of non-monetary benefits that can be considered as minor; - Recital No. 29: reference to “<u>non-substantive</u> material or services”. • Negative definition: Delegated Directive: <ul style="list-style-type: none"> - Recital No. 29: notion of <u>substantive value</u> material or services (<i>a contrario</i> interpretation). - Recital No. 30: exclusion of any minor non-monetary benefit that supposes a third party <u>allocating valuable resources</u> to the IF.
Level 3	ESMA Q&A No. 6: <i>Minor non-monetary benefit vs. research</i> ESMA Q&A No. 9: <i>Research related to fixed-income, currencies or commodities</i>
Transposition into internal law	AMFGR: Article 314-20

GENERAL PRINCIPLES

MiFID II excludes from the regime of Article 13 of the Delegated Directive any minor non-monetary benefit that may be kept by the IF¹⁸, as it presents a low risk of creating conflicts of interest.

A **definition** of minor non-monetary benefits is set out in the provisions specific to investment advice and portfolio management services in **Article 24 (7) and (8) of MiFID II**. Two conditions have to be met:

- These benefits are capable of enhancing the quality of service provided to a client;**
- Their scale and nature are such that they could not be judged to impair compliance with the investment firm’s duty to act in the client’s best interest.**

Moreover, **Article 12 (3) of the Delegated Directive** sets out the **list¹⁹** of non-monetary benefits that can be considered as minor.

QUESTIONS – ANSWERS

¹⁸ Provided that they meet the requirements of Article 12 (3), namely, that they shall be reasonable and proportionate and of such a scale that they are unlikely to influence the investment firm's behaviour in any way that is detrimental and that they shall be disclosed to the client prior to the provision of investment services.

¹⁹ The final paragraph of Article 12 (3) of the Delegated Directive states that “*other minor non-monetary benefits which a Member State deems capable of enhancing the quality of service provided to a client and, having regard to the total level of benefits provided by one entity or group of entities, are of a scale and nature that are unlikely to impair compliance with an investment firm's duty to act in the best interest of the client*”.

3.1 Who is responsible for assessing and deciding whether the document, service or any other benefit received constitutes a minor non-monetary benefit?

It is up to each research consumer to assess and decide whether the document, service or benefit received constitutes a minor non-monetary benefit.

3.2 What can justify that a document, service or any other benefit received constitutes an acceptable minor non-monetary benefit?

It is up to each research consumer to set up a system²⁰ enabling it to assess and categorise the document, service or other benefit received.

To this end, the research consumer may usefully refer to:

- **The list in Article 12 (3) of the Delegated Directive which states that the following benefits are considered as acceptable minor non-monetary benefits when they concern:**
 - “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;
 - written material from a third party that is commissioned and paid for by an corporate issuer or potential issuer to promote a new issuance by the company, or where the third party firm is contractually engaged and paid by the issuer to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any investment firms wishing to receive it or to the general public;
 - participation in conferences, seminars and other training events on the benefits and features of a specific financial instrument or an investment service;
 - hospitality of a reasonable de minimis value, such as food and drink during a business meeting or a conference, seminar or other training events [...]; and
 - other minor non-monetary benefits which a Member States deems capable of enhancing the quality of service provided to a client and [...] are of a scale and nature that are unlikely to impair compliance with an investment firm's duty to act in the best interest of the client.”. By way of example please refer to question 3.6 of the present Section.

- **Recital 29 of the Delegated Directive, which provides further information on how this exemption may be combined with gives some supplementary information concerning the combination of this exemption certain types of information or documents such as:**
 - “non-substantive material or services consisting of short-term market commentary on the latest economic statistics or company results for example;
 - or information on upcoming releases or events, which is provided by a third party and contains only a brief summary of its own opinion on such information that is **not substantiated nor includes any substantive analysis** such as where they simply reiterate a view based on an existing recommendation or substantive research material or services”.

These benefits must otherwise be **reasonable** and **proportionate** and of such a scale that they are unlikely to influence the IF's behaviour in any way that is detrimental to its clients²¹.

²⁰ ESMA states in its Question-Answer No. 6 that it is appropriate to set up “Policies and systems”.

²¹ Pursuant to Article 12 (3) of the Delegated Directive.

3.3 Does the end client have to be informed of the existence of these benefits?

Yes. In any event, the client must be informed, even generically, of the existence of these advantages prior to the provision of any investment service²². This information may, for example, be included in the assessment policy referred to in Article 13 (8) of the Delegated Directive and kept at the client's disposal.

3.4 May a client be charged via a research budget for a non-monetary benefit that is considered as minor by the research consumer?

No. Insofar as the benefit in question is a minor non-monetary benefit, it shall not be invoiced by the research provider to the research consumer and therefore cannot be borne by the latter's own clients.

3.5 Under what circumstances may a document, service or any other research service received not be classed as a minor non-monetary benefit?

If it is judged that this benefit includes a said "*substantive*"²³ added value for the research consumer receiving it, or supposed the "*allocation of valuable resources*"²⁴ by the research provider, it cannot be qualified as a minor non-monetary benefit.

In this situation and as part of its portfolio management and/or independent investment advice activities, the institution may:

- Either maintain this service under the conditions of Article 13 of the Delegated Directive by paying for it (carrying this cost from its own resources or having it borne by the client);**
- Or refuse this service, deemed to compromise its obligation to act in the best interests of its clients.**

3.6 Is the fact that research is made accessible to potential investors or the general public (notably via its publication on a website) a sufficient criterion for it to be qualified as a minor non-monetary benefit?

Yes. Insofar as such research is made freely available to any potential investor or the general public, it is legitimate to consider that it no longer constitutes a particular advantage to the recipient and is therefore no longer likely to generate a conflict of interest. This research can legitimately be qualified as a minor non-monetary benefit when all of the following criteria are met:

- It enhances the quality of the service provided to the client by the research consumer;**
- It constitutes a benefit of such scale and nature that it could not be judged to impair compliance with the research consumer's duty to act in the best interest of the client.**

3.7 Can documentation that is published for a primary transaction be considered as a minor non-monetary benefit?

Yes. Documents written before the close of a given primary issuance by the institutions operationally in charge of such an issuance, mandated and financed for this purpose by the issuer, may be considered as minor non-monetary benefits and therefore do not cause potential conflicts of interest, provided they are made available to prospective investors.

²² In accordance with the provisions of Articles 24 (7) and (8) of MiFID II and Article 12 (3) of the Delegated Directive.

²³ Under Recital 29 of the Delegated Directive.

²⁴ Under Recital 30 of the Delegated Directive.

3.8 Can a research consumer receive research free of charge during a trial period?

In accordance with the new MiFID II provisions on the funding of research, an IF providing a portfolio management or independent investment advice service may not agree to receive a document, service or any other research service unless the conditions provided in Article 13 of the Delegated Directive²⁵ are respected or if such document, service or benefit constitutes a minor non-monetary benefit. As a result, an IF providing a portfolio management or independent investment advice service cannot, in principle, accept research free of charge, including on a trial basis²⁶.

Nevertheless, it could reasonably be considered that research offered **free of charge** under a **strictly controlled, time-limited and non-renewable trial period** can be viewed as minor non-monetary benefits for an IF providing a portfolio management service or independent investment advice.

The purpose of this trial period is solely to enable the research consumer to assess and evaluate the relevance and quality of the research offer and must in this sense be considered to protect the interests of the end-clients. A trial period could be agreed between a research provider and an IF providing a portfolio management service or independent investment advice (hereinafter referred to as "**the parties**") to the extent that the following conditions are respected:

1. the trial period must be offered **prior to the decision to conclude a contract or an agreement between the parties** on the provision of paid research services;
2. the **content of the services offered** within the framework of the trial period must be determined by the parties in advance;
3. the trial period must be strictly defined and limited in time by the parties and may not exceed a **period of three months**;
4. the research consumer gives no monetary or non-monetary consideration to the research provider that may be perceived as an implicit payment (this could be the case of an order flow that is abnormally high when compared to an ordinary flow in the absence of a trial period);
5. the trial period must be subject to a **control mechanism** so that the research consumer ensures that the research services received free of charge during the trial period are not **unduly invoiced to its clients**.
6. the trial period may **not be renewed** by the parties within twelve months of its expiry.

An IF providing a portfolio management service or independent investment advice is therefore permitted to receive research free of charge on a **trial basis only under the predefined conditions** in order to best protect the interests of clients and to ensure that research costs levied from clients are not related to the volume and/or value of transactions, particularly when the IF provides both research and execution services.

It should be recalled that, in any event, the research consumer remains subject to²⁷:

- **A "best selection" obligation when it transmits the order to other entities for the execution of the transaction on behalf of its client;**

²⁵ Article 13 now requires the funding of research through direct payment using the IF's own resources or payment charged to the IF's clients but from a separate research account, as agreed with the client and monitored by the IF, under certain operational and transparency conditions.

²⁶ **ESMA Q&A No. 3:** "In this context, firms should not accept research for 'free'".

²⁷ In accordance with Articles L. 533-18, L. 533-18-1 and L. 533-18-2 of the Monetary and Financial Code.

□ A "best execution" obligation when it executes the order itself on behalf of third parties.

In any case, it is for each research consumer to set up a system enabling it to filter and monitor certain research papers that are sent to it free of charge. ESMA²⁸ indicates some reasonable measures for dealing with unsolicited research, such as setting up automatic blocking or filtering systems and/or contacting the research provider directly to request it to stop sending such research. Furthermore, ESMA adds that it is for each IF to train and raise the awareness of its staff as much as possible of the rules applicable to inducements and to put in place internal procedures enabling staff to report directly to compliance or general management on reception of unsolicited research.

²⁸ ESMA Q&A No. 3.

SECTION NO. 4: MACROECONOMIC ANALYSIS

REFERENCE TEXTS

Level 1	MiFID II: Article 24 (7), (8), (9)
Level 2	<ul style="list-style-type: none"> • Provisions relating to research: Delegated Directive: Recital No. 28. • Provisions relating to minor non-monetary benefits: Delegated Directive: <ul style="list-style-type: none"> - Recital No. 29: notion of <u>substantive value</u> material or service (<i>a contrario</i> interpretation). - Recital No. 30: exclusion of any minor non-monetary benefit that supposes a third party allocating valuable resources to the IF.
Level 3	ESMA Q&A No. 8: <i>Macroeconomic analysis</i> ESMA Q&A No. 9: <i>Research related to fixed-income, currencies or commodities</i>

GENERAL PRINCIPLES

Macroeconomic analysis notes generally cover broad economic aggregates, global balances or one or more geographical regions, and are therefore not specific to any particular security or industry segment.

The research consumer's evaluation of the nature and content of an analysis note received constitutes an essential step for its qualification as research or not and therefore the method via which such research is to be funded.

QUESTIONS – ANSWERS

4.1 Can a macroeconomic analysis note be considered as research?

Yes. The research consumer should analyse the documentation received in the light of the research criteria defined in Recital 28 of the Delegated Directive in order to determine whether it falls within such a classification.

In particular, most macroeconomic analysis is likely to, implicitly or explicitly, suggest an investment strategy. This is notably the case for a note that presents and analyses data on growth, inflation, or interest rates related specifically to certain countries or regions²⁹. When these notes also fulfil the other criteria of the definition of research (as described in Section No. 2) and, in particular, provide a substantiated opinion which can be used to inform an investment strategy, it may be considered that these notes meet the definition of research and can therefore be borne by the end-client via the research budget. In this situation, the research may also be paid directly by the research consumer using its own resources.

²⁹ **ESMA Q&A No. 8:** "ESMA considers, as a starting point, that most macroeconomic analysis is likely to, explicitly or implicitly, suggest an investment strategy (e.g. by providing views on inflation expectations, economic growth, the interest rate curve or currencies for certain countries or regions)".

4.2 Can macroeconomic analysis be funded on a subscription basis?

Yes. A research consumer and a research provider may choose to operate on a subscription basis given the macroeconomic analysis can be adapted and used for a wide variety of investment and management strategies³⁰.

This method of payment may also be considered for the funding of any type of research.

4.3 Under what conditions may a macroeconomic analysis note be qualified as a minor non-monetary benefit?

A macroeconomic analysis note can reasonably be regarded as a minor non-monetary benefit in view of³¹:

- its generic nature in view of its substance; or
- its accessibility to all investors wishing to receive it and/or to the public.

4.4 May a research consumer justify that a macroeconomic analysis note is a minor non-monetary benefit for the sole reason that it is freely accessible to potential investors or the general public (notably via its publication on the research provider's website)?

Yes. Insofar as such research is made freely available to any potential investor or the general public, it is legitimate to consider that it no longer constitutes a particular advantage to the research consumer that receives it and it is therefore no longer likely to generate conflicts of interest.

This approach is explicitly confirmed by ESMA in its **Question-Answer No. 8**, which states that a macroeconomic analysis note made freely available to all institutions wishing to receive it and/or to the public can be legitimately qualified as a minor non-monetary benefit.

³⁰ **ESMA Q&A No. 8:** "ESMA considers that, unlike more asset or sector-specific analysis, macroeconomic research is likely to be relevant to (and able to inform), a variety of strategies and asset allocation decisions across a multiplicity of portfolios. For example, investment firms seeking to comply with Article 13 of the Delegated Directive when receiving macroeconomic analysis may be able to more easily justify paying for it on a subscription basis and allocating costs more broadly across many of its clients' portfolios and accounts".

³¹ **ESMA Q&A No. 8.**

SECTION NO. 5: CORPORATE ACCESS

REFERENCE TEXTS

Level 1	MiFID II: Article 24 (7), (8), (9)
Level 2	<ul style="list-style-type: none"> • Provisions relating to research: Delegated Directive: Recital No. 28. • Provisions relating to minor non-monetary benefits: Delegated Directive: <ul style="list-style-type: none"> - Recital No. 29: notion of <u>substantive value</u> material or service (<i>a contrario</i> interpretation). - Recital No. 30: exclusion of any minor non-monetary benefit that supposes a third party allocating valuable resources to the IF.
Level 3	ESMA Q&A No. 7: <i>Corporate access</i>

GENERAL PRINCIPLES

Corporate access can be defined as when a **third party** (e.g. a market intermediary) **puts an ISP in contact with an issuer** of one or more financial instruments with a view to discussing that issuer's strategy, position or outlook.

Up to now, corporate access has generally been part of the overall services provided by the intermediary and was paid for by the portion of transaction fees dedicated to investment-decision advisory services. Under the new definition of research, the research provider and the research consumer need to further refine the definition of this concept and systematically review it in the light of two criteria relating to the definition of research.

There are two types of practice:

- **The practice that merely involves the straightforward introduction by the provider (the simple physical setting up of meetings), which is similar to providing a "concierge" service;**

- **The practice of combining this straightforward introduction with value-added services of an intellectual nature, such as the preparation, through the intermediary that participated in the meeting, of a detailed analysis note drawing lessons from that meeting, recommending a given strategy in relation to the securities of the issuer concerned or its industry sector and enabling the ISP to form an opinion.**

QUESTIONS – ANSWERS

5.1 Can a purely "concierge" service be included in the research budget and be paid by the client?

No. If the corporate access is similar to a purely "concierge" service, consisting of the "simple" physical setting up of a meeting, it does not meet the definition of research within the meaning of Recital No. 28 of the Delegated Directive³². It cannot therefore be covered by the research budget. The cost of providing a "concierge" service

³² Insofar as it does not explicitly or implicitly recommend or suggest an investment strategy or provide a substantiated opinion as to the present or future value or price of instruments or assets.

may on no account be included in costs related to the intellectual service with which this "conciierge" service is associated, if applicable, in order to be integrated in the research budget.

The research consumer must then decide on the appropriate qualification for this purely "conciierge" service. As such, ESMA explicitly mentions that the choice of the method of funding this benefit will depend on the qualification retained by the research consumer³³.

Following its analysis, the research consumer may consider it to be a minor non-monetary benefit. By way of example, the research consumer's participation in marketing meetings such as roadshows³⁴ organised by a company with a view to promoting a given issuance, provided that such meetings are freely accessible to any financial analyst or potential investor³⁵. In the event that the service can be classified as a minor non-monetary benefit, it can then be accepted without financial compensation.

On the other hand, if the service does not correspond to research or a minor non-monetary benefit, it cannot be charged as part of investment advice or third-party portfolio management service, unless it is considered as a "commercial service" that the research consumer will fund using its own resources.

5.2 How should the research consumer treat value-added services of an intellectual nature resulting from corporate access?

Services of an intellectual nature provided by corporate access, such as a summary of information exchanged during the meeting, may be billed independently of "conciierge" service expenses. These costs may therefore be included in the research budget, unless the research consumer decides to assume these costs from its own resources. In any case, the provision of services of an intellectual nature resulting from corporate access, and the costs related to these services, must not be influenced by the level of fees received for execution services in the case of a research provider that also offers execution services.³⁶

Summary	
Conciierge service	Intellectual value-added service
<p>It may alternatively:</p> <ul style="list-style-type: none"> - be qualified as a minor non-monetary benefit and be received free of charge if it meets the required criteria³⁷; - be paid for by the research consumer's own resources (in particular if it considers this service to be a commercial service). 	<p>It may alternatively:</p> <ul style="list-style-type: none"> - be accepted and paid for: either by the research consumer directly using its own resources or by the end client via the research budget; - be refused: the research consumer cannot accept this benefit deemed to compromise its obligation to act in the best interest of clients.

³³ **ESMA Q&A No. 7:** "ESMA expects investment firms [...] to carefully assess whether corporate access services [...] are material benefits, or alternatively could qualify as an acceptable minor non-monetary benefit".

³⁴ Explicitly targeted in **ESMA Q&A No. 7**.

³⁵ **ESMA Q&A No. 7:** "Freely and publicly open to analysts from investment firms and other investors".

³⁶ Article 13 (9) of the Delegated Directive.

³⁷ See Section No. 3.

SECTION NO. 6: OPERATION OF THE RESEARCH BUDGET

REFERENCE TEXTS

Level 1	MiFID II: Article 24 (7), (8), (9)
Level 2	Delegated Directive: - Article 13 (1) b) i), (5), (6), (8)
Level 3	ESMA Q&A No. 1: <i>Use of a Research Payment Account for more than one client's portfolio or account</i> ESMA Q&A No. 10: <i>Budgeting, allocation of the research budget, determination and assessment of payments made from it</i> ESMA Q&A No. 11: <i>Disclosure of client research charges</i>
Transposition into internal law	AMFGR: Article 314-26

GENERAL PRINCIPLES

Under MiFID II, the mechanism for the funding of research requires the research consumer, to determine a budget in advance, when it decides to charge its clients for research. This mechanism/framework must result in the formalisation of the research consumer's practices and the relationships held with its clients. The research consumer must in particular:

- (i) **Determine and monitor the overall research budget**, which involves:
 - a. **Establishing the research budget** according to the following principles: the budget estimates the cost of research required, it must be sufficiently granular to be pre-apportioned by client, be subject to processes that are particularly rigorous, and be established on an annual basis;
 - b. **Monitoring the budget**, through a robust and independent process for assessing the quality of the research services purchased;
 - c. **Revision of the budget** where necessary, by informing the clients in advance, unless the research consumer itself bears the cost of such additional expenditure.
- (ii) **Allocate the budget by portfolio** based on a previously determined allocation policy that is documented and made available to clients;
- (iii) **Agree on the research budget** with the client and **inform** them regularly about its use, via:
 - a. **Ex-ante information:** the institution agrees with clients on the budgeted research costs and the conditions under which the costs will be charged for the period in question. Moreover, the client must be informed in the event of a budget increase;
 - b. **Ex-post information** on the estimated budget for the research and the amount of the estimated costs as well as on the actual expenses incurred for the purchase of third-party research;
 - c. **Additional information at the request of the client and kept at the AMF's disposal:** the institution is required to provide a summary indicating the list of providers paid through the research payment account, the total amount paid to these providers over the period in question, the benefits and services received by the research consumer, and a comparison

between the total amount paid from the account and the budget set by the institution, noting any rebate or a balance carried forward if residual funds remain in the account.

QUESTIONS – ANSWERS

6.1. What methods should the research consumer use to determine the research budget?

The principle of setting an ex-ante budget is an important element of the research funding mechanism introduced by MiFID II. The budget is an estimate of projected expenses that can be levied on portfolios managed under a similar strategy.

It is for each research consumer to define in its research policy the criteria on which it assesses the quality of the research it receives. The institution must have a clear methodology to determine the amount it intends to allocate for each research provider prior to receiving and consuming their services. In any event, it is up to each research consumer to establish their own scoring tables or thresholds allowing them to adjust what they will pay to research providers.

The research consumer is authorised to adjust the payment *ex-post* made to the research provider in a proportionate and foreseeable manner, that is to say by following pre-determined criteria³⁸.

6.2. Can a research consumer set a research budget for a group of portfolios or for several accounts?

Yes. It is possible for a research consumer to set a budget for a group of portfolios or for several accounts when the investment scope is similar. Thus, the research consumer may decide to set research budgets by desk or investment strategy if the mandates concerned are similar and share the same investment objectives.

On the other hand, it is not possible to set a budget by group of portfolios if they do not share the same research needs and investment objectives sufficiently, such as when they cover different categories of financial instruments, geographical regions or sectors³⁹.

In any event, the research consumer should be capable of identifying and allocating research costs equitably, in an individualised way at the client level, following a pre-defined distribution process.

6.3. How should the agreement between the research consumer and its client over the research budget be formalised?

The client's agreement is required on two items: on the research costs provided for in its forward budget, and on the frequency with which the specific research costs will be deducted. This agreement falls within the portfolio management mandate or in the general terms and conditions of the services agreement.

For existing mandates, after the client has been informed and given the possibility of expressing any opposition, the client's agreement is deemed to have been obtained when:

³⁸ ESMA Q&A No. 10

³⁹ ESMA Q&A No. 1: "Firms should not set a budget for a group of client portfolios or accounts that do not share sufficiently similar investment objectives and research needs".

- **The estimated research expense budget for a given period does not result in an increase in the total fees paid by the client compared to the previous equivalent period; and**
- **The frequency with which the research consumer intends to charge the client for specific research costs over a given period is equivalent to that provided for the previous period for the other costs.**

In this case, it is sufficient to simply provide information on the anticipated research costs and the frequency with which the specific research costs for which the client will be charged. The client retains the right to refuse the budget.

SECTION NO. 7: RESEARCH PAYMENT ACCOUNT

REFERENCE TEXTS

Level 1	MiFID II: Article 24 (7), (8), (9)
Level 2	Delegated Directive: Article 13 (3)
Level 3	ESMA Q&A No. 1: <i>Use of a Research Payment Account for more than one client's portfolio or account</i> ESMA Q&A No. 2: <i>Status of client money held in a Research Payment Account</i> ESMA Q&A No. 10: <i>Budgeting, allocation of the research budget, determination and assessment of payments made from it</i>
Transposition into internal law	AMFGR: Article 314-22

GENERAL PRINCIPLES

When the research consumer decides to charge the client for the research, the new research funding mechanism provides for the use of a **Research Payment Account (RPA)**, which may be operated according to two models:

- **The simple RPA model (sometimes referred to as the Swedish model):** an account funded in line with the budget set in advance (*ex-ante*) with specific costs, charged in addition to management fees and collected from clients according to a frequency and a methodology to be defined by the research consumer. This deduction is carried out independently of the rate at which the transactions are executed, for example through provisioning fees at each portfolio valuation date and regularly deducting them from the outstanding balance;
- **The RPA model based on Commission Sharing Agreements ("CSA"):** research costs are deducted upon the execution of a transaction by the ISP providing execution services on behalf of the research consumer, in addition to execution fees. The research consumer defines and subsequently manages the percentage of fees to be charged for each transaction such that the level of the research costs charged is ultimately in line with the budgeted amount.

QUESTIONS – ANSWERS

7.1. Who is responsible for administering the research payment account?

The research consumer is responsible for the RPA both for its provision, whatever the model, and the payments deducted from it for the benefit of research providers. In this respect, it is up to each research consumer to ensure the account opened with its intermediary benefits from satisfactory legal certainty.

In addition, the research consumer can delegate administration of the RPA to an external provider⁴⁰.

⁴⁰ In accordance with the provisions of Article 13 (7) of the Delegated Directive: "For the purposes of point (b)(iii) of paragraph 1, the investment firm may delegate the administration of the research payment account to a third party, provided that the arrangement facilitates the purchase of third party research and payments to research providers in the name of the investment firm without any undue delay in accordance with the investment firm's instruction".

Finally, since the RPA is the responsibility of the research consumer, it is for this institution to decide whether to set up one or several RPAs.

7.2. Who owns the sums deposited on the research payment account?

The RPA is funded by a payment charged to the client. From the moment this payment is made, the sums credited to this account belong to the research consumer⁴¹.

7.3. Is it possible for the research provider institution to administer a research payment account on behalf of a research consumer whose orders it executes free of charge?

No. Administration of an RPA offered free of charge by a research provider, which is also in charge of the order execution, to a research consumer may be regarded as a form of order execution inducement falling within the scope of Article 12 of the Delegated Directive and is therefore prohibited for research consumers offering independent investment advice and portfolio management services on behalf of third parties.

7.4. Is it still possible to use commission sharing agreements under the new research funding mechanism?

Yes. The new research funding mechanism is not incompatible with the functioning of CSAs, a mechanism whereby research fees are levied upon the execution of transactions by the institution providing execution services on behalf of the research consumer. Indeed, Article 13 (3) of the Delegated Directive stipulates that a “*collection [may be made] alongside a transaction commission*”.

However, the operational processes for monitoring expenses invoiced via CSAs will have to be adjusted in keeping with the following:

- the invoicing of transaction fees to client accounts will have to be carried out separately for execution and research fees;**
- the invoicing of research fees must be subject to the budgetary mechanism described in Article 13 of the Delegated Directive, which means in particular that mechanisms will have to be in place to ensure that invoicing of research fees on portfolios is interrupted when the budget is reached.**

If the RPA is in surplus compared to the budget at the end of the period⁴², the institution shall provide a process to return the funds to the client or include them in the budget and research fees calculated for the next period. If the budget is not reached, unless the institution establishes that its research expenses are ultimately lower than those provided for in the budget, the difference is retroceded to the research providers concerned, i.e., by a direct payment, excluding brokerage fees, and may be charged to clients.

In any case, where research and execution services are provided by a single provider, the institution must take the potential conflicts of interest in its research policy into account and must ensure that internal procedures ensure effective unbundling between research and transaction fees.

In sum, amendments to existing CSAs must be made for them to be compliant with the mechanism provided for by MiFID II.

⁴¹ ESMA Q&A No. 2

⁴² Article 13 (7) of the Delegated Directive