MIFID II Level 2
(draft 16.04.2015)

Item 3

Investor protection issues

- **Safeguarding of client assets**
- **The legitimacy of inducements to be paid to/by a third person**

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SAFEGUARDING OF CLIENT ASSETS

Recitals

(1) The protection of client financial instruments and funds is an important part of the investor protection requirements and investment firms should have proper and specific arrangements in place to ensure the safeguarding of client financial instruments and funds.

(2) Where an investment firm deposits funds it holds on behalf of a client with a qualifying money market fund, the units or shares in that money market fund should be held in accordance with the requirements for holding financial instruments belonging to clients and clients should explicitly consent to such way of depositing client funds.

(3) A single officer with overall responsibility for the safeguarding of client instruments and funds should be appointed in order to reduce risks of fragmented responsibility across diverse departments, especially in large and complex firms, and to remedy unsatisfactory situations where firms do not have overarching sight of their means of meeting their obligations in this area. The single officer should be of a sufficient level of skill and authority in order to discharge his/her duties effectively and without impediment, including the duty to report to the firm’s senior management in respect of his/her oversight of the effectiveness of the firm’s compliance with the safeguarding of client assets requirements. In the case of small investment firms, the appointment of a single officer should not preclude that officer from carrying out additional roles. However, the appointment of a single dedicated officer would be proportionate with respect to firms with responsibility for safeguarding a significant amount of client assets or having complex associated operations in order to ensure effective oversight of client assets.

(4) In light of the effects of title transfer collateral arrangements on firms' duties towards clients and in order to ensure the MiFID safeguarding and segregation rules are not undermined, investment firms should consider the appropriateness of title transfer collateral arrangements (TTCAs) used with non-retail clients by means of the relationship between the client's obligations to the firm and the client assets subject to TTCA. Firms should have a documented process of their use of title transfer collateral arrangements (TTCA). The ability of firms to enter into TTCAs with non-retail clients should not reduce the need to obtain clients' prior express consent to use client assets.

The requirement for considering and demonstrating a robust link between collateral transferred under a TTCA and client's liability should not preclude the taking of appropriate security against a client's obligation and investment firms would, for example, remain able to require sufficient margin, and where appropriate, to do so by a TTCA. Also, this requirement should not prevent compliance with legal requirements under EU legislation such as Regulation (EU) No 648/2012 [EMIR] and does not prohibit the appropriate use of TTCAs in the context of contingent liability transactions or repos for non-retail clients.

(5) While some transactions permitted under Article19 of this Regulation may require the transfer of title of clients' assets, it should be clarified that investment firms should not be able to effect arrangements prohibited under Article 16(10) of Directive 2014/65/EU.

(6) In order to ensure appropriate protection for clients in relation to securities financing transactions (SFT), investment firms should adopt specific arrangements to ensure that the borrower of client assets provides the appropriate collateral and that the firm monitors the continued appropriateness of such collateral. Investment firms' duty to monitor collateral should apply where investment firms are party to an SFT agreement, including when acting as an agent for the conclusion of a SFT or in cases of tripartite agreement between the external borrower, the client and the investment firm.

Prior express consent from clients should be given and recorded by investment firms in order to allow the investment firm to demonstrate clearly what the client agreed to and to help clarify the status of client assets. The term recorded does not prescribe a legal requirement of form and a record is any evidence permissible under national law. Client's consent could be given once at the start of the commercial relationship, as long as it is sufficiently clear that the client has consented to use of their securities in accordance with Article 19. Where an investment firms is acting on a client instruction to lend financial instruments should and where this constitutes consent to entering into the transaction, the investment firms should evidence this in line with Article 19.

(7) Where investment firms place client funds with a third party, the investment firm should exercise all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for holding and safekeeping the client funds, and should consider the need for diversification and mitigation of risks, where appropriate, by placing client funds with more than one third party in order to safeguard the clients' rights and minimise the risk of loss and misuse. Investment firms should not circumvent their duty to consider diversification by requiring clients to waive this protection. Where an investment firm has transferred client funds to a transaction account in order to make a specific transaction, such funds should not be subject to a requirement to diversify.

(8) [In addition to the general requirement to consider the need for diversification, setting a specific limit on the percentage of client funds that can be deposited at an intra-group credit institution should significantly reduce any potential conflicts with due diligence requirements and address the contagion risk inherent in depositing all client funds with a credit institution in the same group as the investment firm. While in certain circumstances a proportionate approach could be appropriate and investment firms might still deposit, after proper consideration, client funds with entities within their own group, national authorities should closely monitor the reasons for not diversifying client funds outside of the investment firm's group in order to avoid creating loopholes in the way in which the general intragroup limit is applied.

(9) In order to protect client financial instruments or funds from appropriation by third parties seeking to recover debts or charges which are not client's debts or charges, investment firms should be able to agree to security interests, liens or rights of sett-off over client assets only where this is required by the applicable law in a third country. Sufficiently tailored risk disclosures should be made to clients in order to alert them to the specific risks they face in such cases.

Articles

Article 16

Safeguarding of client financial instruments and funds

(Article 16(8) to (10) of Directive 2014/65/EU)

1. For the purposes of safeguarding clients' rights in relation to financial instruments and funds belonging to them, investment firms comply with the following requirements:

   (a) they must keep such records and accounts as are necessary to enable them at any time and without delay to distinguish assets held for one client from assets held for any other client, and from their own assets;

   (b) they must maintain their records and accounts in a way that ensures they may be used as an audit trail, their accuracy, and in particular their correspondence to the financial instruments and funds held for clients;

   (c) they must conduct, on a regular basis, reconciliations between their internal accounts and records and those of any third parties by whom those assets are held;

   (d) they must take the necessary steps to ensure that any client financial instruments deposited with a third party, in accordance with Article 17, are identifiable separately from the financial instruments belonging to the investment firm and from financial instruments belonging to that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection;

   (e) they must take the necessary steps to ensure that client funds deposited, in accordance with Article 18, in a central bank, a credit institution or a bank authorised in a third country or a qualifying money market fund are held in an account or accounts identified separately from any accounts used to hold funds belonging to the investment firm;

(f) they must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.

2. If, for reasons of the applicable law, including in particular the law relating to property or insolvency, the arrangements made by investment firms in compliance with paragraph 1 to safeguard clients' rights are not sufficient to satisfy the requirements of Article 16(8) and (9) of Directive 2014/65/EU, Member States shall prescribe the measures that investment firms must take in order to comply with those obligations.

3. If the applicable law of the jurisdiction in which the client funds or financial instruments are held prevents investment firms from complying with points (d) or (e) of paragraph 1, Member States shall prescribe requirements which have an equivalent effect in terms of safeguarding clients' rights.

When relying on such equivalent requirements under Article 16(1)(d) or (e), investment firms shall inform clients that in such instances they do not benefit from the provisions envisaged under Directive 2014/65/EU and this Regulation.

4. Security interests, liens or rights of set-off over client financial instruments or funds enabling a third party to dispose of client's financial instruments or funds in order to recover debts that do not relate to the client or provision of services to the client shall not be permitted except where this is required by applicable law.

Where a firm is obliged to enter into agreements that create such security interests, liens or rights of set-off, the firm shall disclose this information to clients so that they are informed of the risks associated with these arrangements.

Where security interests, liens or rights of set-off are granted by the firm over client financial instruments or funds, or where the firm has been informed that they are granted, these shall be recorded in client contracts and the firm's own accounts to make the ownership status of client assets clear, e.g. in the event of an insolvency.

5. Investment firms shall make information in relation to clients financial instruments and funds readily available to competent authorities, insolvency practitioners and those responsible for the resolution of failed institutions, including the following information:

(a) related internal accounts and records that readily identify the balances of funds and instruments held for each client;

(b) where client funds are held by the investment firm in accordance with Article 18, details of the accounts where client funds are held and the relevant agreements with those entities;

(c) where financial instruments held by the investment firm in accordance with Article 17, details of accounts opened with third parties and the relevant agreements with those entities;

(d) details of third parties carrying out any related (outsourced) tasks;

(e) key individuals of the firm involved in related processes, including those responsible for oversight of the firm's requirements in relation to the safeguarding of client assets; and

(f) relevant client agreements.

Article 17

(Article 16(8) of Directive 2014/65/EU)

Depositing client financial instruments

1. Investment firms may deposit financial instruments held by them on behalf of their clients into an account or accounts opened with a third party provided that the firms exercise all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for the holding and safekeeping of those financial instruments.

   In particular, investment firms shall take into account the expertise and market reputation of the third party as well as any legal requirements related to the holding of those financial instruments that could adversely affect clients' rights.

2. If the safekeeping of financial instruments for the account of another person is subject to specific regulation and supervision in a jurisdiction where an investment firm proposes to deposit client financial instruments with a third party, the investment firm shall not deposit those financial instruments in that jurisdiction with a third party which is not subject to such regulation and supervision.

3. Investment firms shall not deposit financial instruments held on behalf of clients with a third party in a third country that does not regulate the holding and safekeeping of financial instruments for the account of another person unless one of the following conditions is met:

   (a) the nature of the financial instruments or of the investment services connected with those instruments requires them to be deposited with a third party in that third country;

   (b) where the financial instruments are held on behalf of a professional client, that client requests the firm in writing to deposit them with a third party in that third country.

Article 18

(Article 13(8) of Directive 2014/65/EU)

Depositing client funds

1. Investment firms shall, on receiving any client funds, promptly place those funds into one or more accounts opened with any of the following:

   (a) a central bank;

   (b) a credit institution authorised in accordance with Directive 2000/12/EC;

   (c) a bank authorised in a third country;

(d) a qualifying money market fund.

The first subparagraph shall not apply to a credit institution authorised under Directive 2013/36/EU in relation to deposits within the meaning of that Directive held by that institution.

2. For the purposes of point (d) of paragraph 1, and of Article 16(1)(e), a 'qualifying money market fund' means a collective investment undertaking authorised under Directive 2009/65/EC, or a money market fund which is subject to harmonised rules laid down by [the subsequent] Union law or which is subject to supervision and, if applicable, authorised by an authority under the national law of a Member State, and which satisfies the following conditions:

(a) its primary investment objective must be to maintain the net asset value of the undertaking either constant at par (net of earnings), or at the value of the investors' initial capital plus earnings;

(b) it must, with a view to achieving that primary investment objective, invest exclusively in high quality money market instruments with a maturity or residual maturity of no more than 397 days, or regular yield adjustments consistent with such a maturity, and with a weighted average maturity of 60 days. It may also achieve this objective by investing on an ancillary basis in deposits with credit institutions;

(c) it must provide liquidity through same day or next day settlement.

For the purposes of point (b), a money market instrument shall be considered to be of high quality if the management/investment company performs its own documented assessment of the credit quality of money market instruments that allows it to consider a money market instrument as high quality. Where one or more credit rating agencies registered and supervised by ESMA have provided a rating of the instrument, the management/investment company's internal assessment should have regard to, inter alia, those credit ratings. While there should be no mechanistic reliance on such external ratings, a downgrade below the two highest short-term credit ratings by any agency registered and supervised by ESMA that has rated the instrument should lead the manager to undertake a new assessment of the credit quality of the money market instrument to ensure it continues to be of high quality.

3. Where investment firms do not deposit client funds with a central bank, they shall exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or money market fund where the funds are placed and the arrangements for the holding of those funds and shall consider the need for diversification of these funds as part of their due diligence.

In particular, investment firms shall take into account the expertise and market reputation of such institutions or money market funds with a view to ensuring the protection of clients' rights, as well as any legal or regulatory requirements or market practices related to the holding of client funds that could adversely affect clients' rights.

Investment firms shall ensure that clients give their explicit consent to the placement of their funds in a qualifying money market fund. In order to ensure this right to consent is effective, investment firms shall inform clients that funds placed with a qualifying money market fund will not be held in accordance with the requirements for safeguarding client funds.

4. Where investment firms deposit client funds with a credit institution, bank or money market fund of the same group as the investment firm, they shall limit the funds that they deposit with any such group entity or combination of any such group entities so that funds do not exceed 20% of all such funds.

An investment firm may not comply with this limit if it is able to demonstrate that, in view of the nature, scale and complexity of its business, and also the safety offered by the third parties considered in the previous subparagraph, and including in any case the small balance of client funds it holds, the requirement under the previous paragraph is not proportionate. Investment firms shall periodically review the assessment made in accordance with this subparagraph and shall notify their initial and reviewed assessments to NCAs.

Article 19

(Article 16(8) of Directive 2014/65/EU)

Use of client financial instruments

1. Investment firms shall not enter into arrangements for securities financing transactions in respect of financial instruments held by them on behalf of a client, or otherwise use such financial instruments for their own account or the account of any other person or client of the firm, unless the following conditions are met:

   (a) the client must have given his prior express consent to the use of the instruments on specified terms, as clearly evidenced in writing and affirmatively executed by signature or equivalent;

   (b) the use of that client's financial instruments must be restricted to the specified terms to which the client consents.

2. Investment firms shall not enter into arrangements for securities financing transactions in respect of financial instruments which are held on behalf of a client in an omnibus account maintained by a third party, or otherwise use financial instruments held in such an account for their own account or for the account of any other person unless, in addition to the conditions set out in paragraph 1, at least one of the following conditions is met:

   (a) each client whose financial instruments are held together in an omnibus account must have given prior express consent in accordance with point (a) of paragraph 1;

   (b) the investment firm must have in place systems and controls which ensure that only financial instruments belonging to clients who have given prior express consent in accordance with point (a) of paragraph 1 are so used.

The records of the investment firm shall include details of the client on whose instructions the use of the financial instruments has been effected, as well as the number of financial instruments used belonging to each client who has given his consent, so as to enable the correct allocation of any loss.

3. Investment firms shall take appropriate measures to prevent the unauthorised use of client financial instruments for their own account of the account of any other person such as:

(a) the conclusion of agreements with clients on measures to be taken by the investment firms in case the client does not have the provision on its account on the settlement date, such as borrowing of the corresponding securities on behalf of the client or unwinding the position;

(b) the close monitoring by the investment firm of its projected ability to deliver on the settlement date and the putting in place remedial measures if this cannot be done; and

(c) the close monitoring and prompt requesting of undelivered securities outstanding on the settlement day and beyond.

4. Investment firms shall adopt specific arrangements for all clients to ensure that the borrower of client financial instruments provides the appropriate collateral and that the firm monitors the continued appropriateness of such collateral and takes the necessary steps to maintain the balance with the value of client instruments.

5. Investment firms shall not enter into arrangements which are prohibited under Article 16(10) of Directive 2014/65/EU.

Article 19a

(Article 16(3), (8) and (9) of Directive 2014/65/EU)

Inappropriate use of title transfer collateral arrangements

1. For the purposes of ensuring the best interests of professional clients and eligible counterparties and safeguarding their rights in relation to financial instruments and funds belonging to them, investment firms shall properly consider, and be able to demonstrate that they have done so, the use of title transfer collateral arrangements in the context of the relationship between the client's obligation to the firm and the client assets subjected to title transfer collateral arrangements by the firm. When considering, and documenting, the appropriateness of the use of title transfer collateral arrangements, investment firms shall take into account the following factors:

(a) whether there is only a very weak connection between the client's obligation to the firm and the use of title transfer collateral arrangements, including whether the likelihood of a liability arising is low or negligible;

(b) whether the amount of client funds or financial instruments subject to title transfer collateral arrangements far exceeds the client's obligation, or is even unlimited if the client has any obligation at all to the firm; or

(c) whether all clients' financial instruments or funds are made subject to title transfer collateral arrangements, without consideration of what obligation each client has to the firm.

2. Where using title transfer collateral arrangements, investment firms shall highlight to professional clients and eligible counterparties the risks involved and the effect of

any title transfer collateral arrangement on the client’s financial instruments and funds.

Article 19b

Governance arrangements concerning the safeguarding of client assets

(Article 16(8) to (10) of Directive 2014/65/EU)

Investment firms shall appoint a single officer of sufficient skill and authority with specific responsibility for matters relating to the compliance by firms with their obligations regarding the safeguarding of client financial instruments and funds.

Investment firms shall decide, in view of the nature, scale and complexity of their business and the nature and range of investment services and activities, whether the appointed officer is to be dedicated solely to this task or to have additional responsibilities.

Article 20

(Article 16(8) to (10) of Directive 2014/65/EU)

Reports by external auditors

Investment firms shall ensure that their external auditors report at least annually to the competent authority of the home Member State of the firm on the adequacy of the firm's arrangements under Articles 16(8) to (10) of Directive 2014/65/EU and this Section.

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THE LEGITIMACY OF INDUCEMENTS TO BE PAID TO/BY A THIRD PERSON

Recitals

(1) In order to strengthen the protection of investors and increase clarity to clients as to the quality of services they receive, Directive 2014/65/EU further restricted the possibility for firms to receive or pay inducements. For these purposes, this Regulation should clarify the conditions for the reception or payment of inducements. In particular, the condition that inducements should enhance the quality of the service to the client should be further specified and framed. While investment firms should, once they have fulfilled the quality enhancement criterion, maintain the enhanced level of quality, this should not imply they are required to provide for a continuously increasing quality of services over time.

(2) This Regulation should also specify investment firms’ obligations to pass on to clients all fees, commissions or benefits received from third-parties in relation to investment advice on an independent basis or portfolio management services. While firms should pass on inducements as soon as possible, a specific timeframe should not be imposed since third party payments can be received by the investment firm at various points in time and for several clients at once.

(3) In order to ensure clients' comprehensive overview of the relevant information in respect of the services provided, investment firms should inform clients about the fees, commissions or any monetary or non-monetary benefits transferred to them.

Articles

Article 26

Inducements

(Article 24(9) of Directive 2014/65/EU)

1. Investment firms shall not be 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, that do not fulfil the cumulative conditions set out in Article 24(9). Investment firms shall take appropriate measures to ensure that these conditions and the following requirements are met on a case-by-case basis.

2. A fee, commission or monetary or non-monetary benefit shall generally not be regarded as designed to enhance the quality of the relevant service to the client if any of the following conditions is applicable:

   (a) it is not justified by the provision of an additional or higher level service to the relevant client, proportional to the level of inducements received, such as:

      (i) the provision of investment advice, on a non-independent basis, on and access to a wide range of suitable financial instruments including an appropriate number of instruments from third party product providers having no close links with the investment firm;

      (ii) the provision of non-independent advice combined with either: an offer to the client, at least on an annual basis, to assess the continuing suitability of the financial instruments in which the client has invested; or with another on-going service that is likely to be of value to the client such as advice about the suggested optimal asset allocation of the client; or

      (iii) the provision of access, at a competitive price, to a wide range of financial instruments that are likely to meet the needs of the target market, including an appropriate number of instruments from third party product providers having no close links with the investment firm, together with either the provision of added-value tools, such as objective online information tools helping the relevant client to take investment decisions or enabling the relevant client to monitor, model and adjust the range of financial instruments in which they have invested, or providing periodic reports of the performance and costs and charges associated with the financial instruments;

   (b) it directly benefits the recipient firm, its shareholders or employees without tangible benefit to the relevant client; or

   (c) it is not justified by the provision of an on-going benefit to the relevant client in relation to an on-going inducement.

A fee, commission or monetary or non-monetary benefit shall not be considered acceptable if the provision of relevant services to the client is biased or distorted as a result of the fee, commission or monetary non-monetary benefit.

3. Once investment firms have fulfilled the quality enhancement criterion, they shall maintain the enhanced level of quality.

4. Investment firms shall ensure they are able to clearly demonstrate that any fees, commissions or monetary or non-monetary benefits paid or received by the firm are designed to enhance the quality of the service to the client:

   (a) by keeping an internal list of all fees, commissions and monetary or non-monetary benefits received by the investment firm from a third party in relation to the provision of investment or ancillary services; and

   (b) by recording how the fees, commissions and monetary or non-monetary benefits used by the investment firm, or that it intends to use, enhance the quality of the services provided to the relevant clients and the steps taken in order not to impair the firm's duty to act honestly, fairly and professionally in accordance with the best interests of the client.

5. In relation to any payment or benefit received from or paid to third parties, investment firms shall disclose to the client the following information:

   (a) prior to the provision of the relevant investment or ancillary service, the investment firm shall disclose to the client in a clear, comprehensive, accurate and understandable manner, the existence, nature and amount of the payment or benefit concerned. Where the amount of payments cannot be ascertained, the method of calculating that amount must be clearly disclosed to the client. Minor non-monetary benefits may be described in a generic way. Other non-monetary benefits received or paid by the investment firm in connection with the investment service provided to a client shall be priced and disclosed separately;

   (b) where an investment firm was unable to ascertain on an ex-ante basis the amount of any payment or benefit to be received or paid, and instead disclosed to the client the method of calculating that amount, the firm shall also provide its clients with information of the exact amount of the inducement received on an ex-post basis in accordance with Article 24(9) of Directive 2014/65/EU;

   (c) at least once a year, as long as (on-going) inducements are received by the investment firm in relation to the investment services provided to the relevant clients, the investment firm should inform its clients on an individual basis about the actual amount of payments or benefits received.

   In implementing these requirements, investment firms shall take into account the costs and charges rules set out in [Article XX].

   When a number of firms are involved in a distribution channel, each investment firm that is providing an investment or ancillary service must comply with its obligations to make disclosures to its clients.

Article 26a

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

(Article 24(7) and 24(8) of Directive 2014/65/EU)

1. For the purposes of paragraphs 7 and 8 of Article 24 of Directive 2014/65/EU, investment firms providing investment advice on an independent basis or portfolio management must 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 fully transferred to the client money account.

   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. Investment firms providing investment advice on an independent basis or portfolio management shall not receive non-monetary benefits that do not qualify as minor.

3. Investment firms providing investment advice on an independent basis or portfolio management shall not accept non-monetary benefits that do not qualify as minor non-benefits capable of enhancing the quality of service provided to a client and of a scale and nature such that they could not be judged to impair compliance with the investment firm's duty to act in the best interest of the client.

   Acceptable minor non-monetary benefits 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 to the interests of the relevant client. The following benefits shall qualify as minor non-monetary benefits:

   (a) information or documentation relating to a financial instrument or an investment service. This information could be generic in nature or personalised to reflect the circumstances of an individual client;

   (b) participation in conferences, seminars and other training events on the benefits and features of a specific financial instrument or an investment service; and

   (c) hospitality of a reasonable *de minimis* value, such as food and drink during a business meeting or a conference, seminar or other training events mentioned under (b).

   Minor non-monetary benefits shall be clearly disclosed by investment firms prior to the provision of the relevant investment or ancillary services to clients.

Article 26b

Inducements *rules in relation to* investment research

1. The provision of research by third parties to investment firms providing portfolio management or other investment or ancillary services to clients shall not be regarded as an inducement if it is received in return for:

   (a) direct payments by the investment firm out of its own resources, which it may choose to reflect in whole or in part in an increase to the firm's portfolio management or service fees, or

   (b) payments from a separate research payment account controlled by the investment firm, provided the following conditions relating to the operation of this account are met:

      i. the research payment account shall only be funded by a specific research charge to the client. The specific research charge shall:

         – only be based on a research budget set by the investment firm for the purpose of establishing the need for third party research in respect of investment services rendered to its clients; and

         – not be linked to the volume and/or value of transactions executed on behalf of the clients.

         The total amount of research charges received in the research payment account may not exceed the research budget.

         The investment firm must agree with clients, in the firm's investment management agreement or general terms of business, the research charge as budgeted by the firm and the frequency with which the specific research charge will be deducted from the resources of the client over the year. Increases in the research budget shall only take place after the provision of clear information to clients about such intended increases. If there is a surplus in the research payment account at the end of a period, the firm should have a process to rebate those funds to the client or to offset it against the research budget and charge calculated for the following period.

      ii. As part of establishing a research payment account and agreeing the research charge with their clients, investment firms must set and regularly assess a research budget as an internal administrative measure. The research budget is managed solely by the investment firm and is based on a reasonable assessment of the need for third party research. The allocation of the research budget to purchase third party research should be subject to appropriate controls and senior management oversight to ensure it is managed and used in the best interests of the firm's clients. Such controls include a clear audit trail of payments made to research providers and how the amounts paid were determined with reference to the quality criteria referred to in point (iv) below. Investment firms may not use the research budget and research payment account to fund internal research.

iii. The investment firm shall be responsible for operating the research payment account. The investment firm may delegate the administration of the research payment ac-count 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.

iv. The investment firm shall regularly assess the quality of the research purchased based on robust quality criteria and its ability to contribute to better investment decisions. Investment firms shall establish these elements in a written policy and provide it to their clients. It shall also address the extent to which research purchased through the research payment account may benefit clients' portfolios, including, where relevant, by taking into account investment strategies applicable to various types of portfolios, and the approach the firm will take to allocate such costs fairly to the various clients' portfolios.

v. Where an investment firm makes use of the research payment account, it shall provide the following information to clients:

– In line with Article 24(4)(c) of Directive 2014/65/EU, clients shall be informed ex ante about the budgeted amount for research and the amount of the expected research charge for each of them.

– In line with Article 24(4)c of Directive 2014/65/EU clients shall receive annual information on the total costs that each of them has incurred for third party research. The investment firm shall also be required, upon request by their clients or by competent authorities, to provide a summary of the providers paid from this account, the total amount they were paid over a defined period, the benefits and services received by the investment firm, and how the total amount spent from the account compares to the budget set by the firm for that period, noting any rebate or carry-over if residual funds remain in the account.

2. Investment firms providing execution services shall identify separate charges for these services that only reflect the cost of executing the transaction. The provision of any other benefits or services shall be subject to a separately identifiable charge; the supply of these goods or services should not be influenced by or be conditional on levels of payment for execution services.

[Market participants have raised concerns about the operational impact of the requirements as drafted. The Commission Services have identified a number of adjustments designed to reduce the impact whilst preserving the objectives of the level 1 rules. Are there further operational adjustments that are necessary or helpful in limiting the impact of these measures whilst preserving the objectives of breaking the link between the purchase of research and the payment for execution and of disclosure regarding costs for research?]