Commission Delegated Directive (EU) 2017/593 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 (Text with EEA relevance)

COMMISSION DELEGATED DIRECTIVE (EU) 2017/593

of 7 April 2016

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(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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[(1)], and in particular Articles 16(12) and 24(13) thereof,

Whereas:

(1) Directive 2014/65/EU sets out comprehensive regime aiming to ensure investor protection.

(2) The protection of client financial instruments and funds is an important part of that regime, investment firms being subject to an obligation to make adequate arrangements to safeguard investor's ownership and rights in respect of securities and funds entrusted to an investment firm. Investment firms should have in place proper and specific arrangements to ensure the safeguarding of client financial instruments and funds.

(3) In order to further specify the regulatory framework for the protection of investors and increased clarity to clients, and in line with the overall strategy to foster jobs and growth in the Union through an integrated legal and economic framework that is efficient and treats all actors fairly, the Commission has been empowered to adopt detailed rules to address specific risks to investor protection or to market integrity.

(4) 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. Clients should be required to explicitly consent to the depositing of those funds. When assessing the quality of money market instrument there should be no mechanistic reliance on external ratings. However 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.

(5) 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. The single officer should possess sufficient skills and authority in order to discharge duties effectively and without impediment, including the duty to report to the firm's senior management in respect of oversight of the effectiveness of the firm's compliance with the safeguarding of client assets requirements. The appointment of a single officer should not preclude that officer from carrying out additional roles where this does not prevent the officer from discharging the duties for safeguarding client financial instruments and funds effectively.

(6) Directive 2014/65/EU requires investment firms to safeguard client assets. Article 16(10) of Directive 2014/65/EU prohibits firms from concluding title transfer collateral arrangements (TTCAs) with retail clients for the purpose of securing or covering present or future, actual or contingent or prospective obligations. Investment firms are, however, not prohibited from concluding TTCA with non-retail clients. There is therefore a risk that without further guidance investment firms could use TTCA more often than reasonably justified when dealing with non-retail clients, undermining the overall regime put in place to protect client assets. Therefore, in light of the effects of TTCAs on firms' duties towards clients and in order to ensure the safeguarding and segregation rules pursuant to Directive 2014/65/EU are not undermined, investment firms should consider the appropriateness of title transfer collateral arrangements 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 be allowed to use TTCA with non-retail client only if they demonstrate the appropriateness of TTCA in relation to that client and disclose the risks involved as well as the effect of the TTCA on his assets. Firms should have a documented process of their use 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.

(7) Demonstrating a robust link between collateral transferred under a TTCA and client's liability should not preclude taking appropriate security against a client's obligation. Investment firms could thus continue to require a sufficient collateral and where appropriate, to do so by a TTCA. That obligation should not prevent compliance with requirements under Regulation (EU) No 648/2012 of the European Parliament and of the Council[(2)] and should not prohibit the appropriate use of TTCAs in the context of contingent liability transactions or repos for non-retail clients.

(8) While some securities financing transactions may require the transfer of title of clients' assets, in that context investment firms should not be able to effect arrangements prohibited under Article 16(10) of Directive 2014/65/EU.

(9) In order to ensure appropriate protection for clients in relation to securities financing transactions (SFTs), 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 they 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.

(10) Prior express consent by 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. However, no legal requirement should be set out in respect of the form in which consent may be given, and a record should be understood as any evidence permissible under national law. Client's consent may 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. Where an investment firm is acting on a client instruction to lend financial instruments and where this constitutes consent to entering into the transaction, the investment firms should hold evidence to demonstrate this.

(11) To maintain a high standard of investor protection, investment firms depositing financial instruments held on behalf of their clients into an account or accounts opened with a third party should 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. To ensure that financial instruments are subject to due care and protection at all times, investment firms should, as part of their due diligence, also take into account the expertise and market reputation of the other third parties to which the initial third-party, with whom they might deposit financial instruments, may have delegated functions concerning the holding and safekeeping of financial instruments.

(12) 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 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 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 protection. Diversification requirement should apply to client funds deposited in accordance with Article 4 of this Directive. Diversification requirements should not apply to client funds placed with the third party merely for the purpose of executing a transaction for the client. Therefore where an investment firm has transferred client funds to a transaction account in order to make a specific transaction for the client, such funds should not be subject to a requirement to diversify, for example where a firm has transferred funds to a central counterparty (CCP) or exchange in order to pay a margin call.

(13) In order to ensure that client funds are adequately protected, as required by Article 16(9) of Directive 2014/65/EU, it is necessary to set a specific limit on the percentage of client funds that can be deposited at an intra-group credit institution. This 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 it may be proportionate and appropriate for investment firms to 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 where the general intragroup limit is applied.

(14) 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 set-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.

(15) In order to avoid and reduce from an early stage potential risks of failure to comply with investor protection rules, investment firms manufacturing and distributing financial instruments should comply with product governance requirements. For the purpose of product governance requirements, investment firms that create, develop, issue and/or design financial instruments, including when advising corporate issuers on the launch of new financial instruments, should be considered as manufacturers while investment firms that offer or sell financial instrument and services to clients should be considered distributors.

(16) Entities which are not subject to the requirements of Directive 2014/65/EU but which may be authorised to perform investment services under that Directive, should also comply, as regards such services, with the product governance requirements set out under Directive 2014/65/EU.

(17) Where an investment firm that creates, develops, issues or designs financial instruments is also involved in the distribution of those products, both the product governance rules for manufacturers and distributors should apply. While there is no need to duplicate the target market assessment and distribution strategy exercise, firms should ensure the single target market assessment and distribution strategy exercise is sufficiently detailed to meet the relevant manufacturer and distributor obligations in this area.

(18) In light of the requirements set out in Directive 2014/65/EU and in the interest of investor protection, product governance rules should apply to all products sold on primary and secondary markets, irrespective of the type of product or service provided and of the requirements applicable at point of sale. However, those rules may be applied in a proportionate manner, depending on the complexity of the product and the degree to which publicly available information can be obtained, taking into account the nature of the instrument, the investment service and the target market. Proportionality means that these rules could be relatively simple for certain simple, products distributed on an execution-only basis where such products would be compatible with the needs and characteristics of the mass retail market.

(19) The level of granularity of the target market and the criteria used to define the target market and determine the appropriate distribution strategy should be relevant for the product and should make it possible to assess which clients fall within the target market,

for example to assist the ongoing reviews after the financial instrument is launched. For simpler, more common products, the target market could be identified with less detail while for more complicated products such as bail-inable instruments or less common products, the target market should be identified with more detail.

(20) For the efficient functioning of product governance obligations, distributors should periodically inform the manufacturers about their experience with the products. While distributors should not be required to report every sale to manufacturers, they should provide the data that is necessary for the manufacturer to review the product and check that it remains consistent with the needs, characteristics and objectives of the target market defined by the manufacturer. Relevant information could include data about the amount of sales outside the manufacturer's target market, summary information of the types of clients, a summary of complaints received or by posing questions suggested by the manufacturer to a sample of clients for feedback.

(21) 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 those purposes, detailed conditions for the reception or payment of inducements should be laid down. In particular, the condition that inducements should enhance the quality of the service to the client should be further specified and framed. For that purpose, and subject to certain other conditions, a non-exhaustive list of situations deemed relevant for the condition that inducements enhance the quality of the service to the relevant client should be provided for.

(22) A fee, commission or non-monetary benefit should only be paid or received where justified by the provision of an additional or higher level service to the relevant client. That may include the provision of investment advice on and access to a wide range of suitable financial instruments including an appropriate number of instruments from third party product providers, or 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 ongoing service that is likely to be of value to the client. This could also be the case, in the area of non-advisory services, where investment firms provide access, at a competitive price, to a wide range of financial instruments that are likely to meet the needs of the client, including an appropriate number of instruments from third party product providers having no close links with the investment firm, together with, for instance, the provision of added-value tools, such as objective 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. The value of the above-mentioned quality enhancements that the investment firm provides to the clients receiving the relevant service has to be proportional to the inducements received by the investment firm.

(23) While investment firms should, once they have fulfilled the quality enhancement criterion, maintain the enhanced level of quality, this should not imply that they are required to provide for a continuously increasing quality of services over time.

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

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

(26) Investment firms providing both execution and research services should price and supply them separately in order to enable investment firms established in the Union to comply with the requirement to not accept and retain fees, commissions or any monetary or non-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 the service to clients set out in Article 24(7) and (8) of Directive 2014/65/EU.

(27) In order to provide legal certainty concerning the application of new rules for the reception or payment of inducements, in particular with respect to investment firms providing investment advice on an independent basis or portfolio management services, further clarifications in relation to the payment or reception of research should be provided. In particular, where research is not paid directly by the investment firm out of its own resources but in return for payments from a separate research payment account certain essential conditions should be ensured. The research payment account should only be funded by a specific research charge to the client which should only be based on a research budget set by the investment firm and not linked to the volume and/or value of transactions executed on behalf of clients. Any operational arrangements for the collection of the client's research charge should fully comply with those conditions. When using such arrangements, an investment firm should ensure that the cost of research funded by client charges is not linked to the volume or value of other services or benefits or used to cover any other purposes, such as charges for execution.

(28) In order to ensure that portfolio managers and independent investment advisers properly monitor the amounts paid for research and to ensure that research costs are incurred in the best interests of the client, it is appropriate to specify detailed governance requirements on research spending. Investment firms should retain sufficient control over the overall spending for research, the collection of client research charges and the determination of payments. Research in this context should be understood as covering research material 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. That 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 otherwise 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 investment firm's decisions on behalf of clients being charged for that research.

(29) For further clarity concerning the restriction on the receipt of inducements by investment firms in relation to independent investment advice or portfolio management and the application of research rules, it is also appropriate to indicate how the minor non-monetary benefit exemption may be applied in relation to certain other types of information or material received from third parties. In particular, written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by that company, or where the third party is contractually engaged and paid by the issuer to produce such material on an ongoing basis, should be deemed acceptable as a minor non-monetary benefit subject to disclosure and the open availability of that material. In addition, 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, can be deemed to be information relating to a financial instrument or investment service of a scale and nature such so that it constitutes an acceptable minor non-monetary benefit.

(30) In particular, any non-monetary benefit that involves a third party allocating valuable resources to the investment firm shall not be considered as minor and shall be judged to impair compliance with the investment firm's duty to act in their client's best interest.

(31) This Directive respects the fundamental rights and observes the principles recognised in the Charter of Fundamental Rights of the European Union and in particular the right to the protection of personal data, the freedom to conduct a business, the right to consumer protection, the right to an effective remedy and to a fair trial and has to be applied in accordance with those rights and principles.

(32) The European Securities and Markets Authority, established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council[(3)], has been consulted for technical advice on the rules laid down in this Directive.

(33) In order to allow competent authorities and investment firms to adapt to the new requirements contained in this Directive so that they can be applied in an efficient and effective manner, the date of transposition as well as date of application of this Directive should be aligned respectively with the transposition and entry into application dates of Directive 2014/65/EU,

(34) In accordance with the Joint Political Declaration of Member States and the Commission of 28 September 2011 on explanatory documents, Member States have undertaken to accompany, in justified cases, the notification of their transposition measures with one or more documents explaining the relationship between the components of a directive and the corresponding parts of national transposition instruments,

HAS ADOPTED THIS DIRECTIVE:

(**1**) OJ L 173, 12.6.2014, p. 349.

(**2**) Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories (OJ L 201, 27.7.2012, p. 1).

(**3**) Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).