

## Briefing note

### ***ESMA Q&A on MiFID II inducements rules (research)*** **Updated by ESMA on 4 April 2017**

The European Securities and Markets Authority (ESMA) has updated its Q&A for research (as inducements) on 4 April 2017, as part of a broader release of [Q&As on investor protection](#). The research questions are covered on pages 41-52. The paper provides guidance on how firms should interpret the research provisions in MiFID II and delegated legislation. The Q&As contain all previous ESMA guidance on research (from 2016) as well. Previous questions are numbered 1-6 and the new ones are 7-11.

The main elements of the 4 April 2017 publication are:

- **Corporate Access:** ESMA does not consider that arranging meetings is research because it does not "explicitly or implicitly recommend or suggest an investment strategy and provide a substantiated opinion as to the present or future value or price of such instruments or assets".
- **Macro-economic analysis:** if macro-economic analysis explicitly or implicitly suggests an investment strategy, macro-economic analysis is considered research. Only macro-economic analysis openly available and generic in nature could be considered a minor non-monetary benefit.
- **FICC (Fixed-income, currencies and commodities) research:** Like equity research, FICC or other asset analysis should be either considered research or a minor non-monetary benefit – in other words there is no differential treatment for FICC.
- **Allocation of research budgets:** Investment firm research budgets need to be built on ex-ante estimates of research spending. There should also be: (1) a clear audit trail of the payments made to research providers; (2) controls over how amounts paid are determined based on the quality criteria established by the firm; and (3) well documented decisions to minimise conflicts of interest.
- **Disclosure of research costs to end-clients:** At least the budget amount per strategy and the estimated research charge should be provided by the asset manager to its end-clients, both as a percentage and a cash amount.

#### Corporate Access (Question 7)

- ESMA refers to a definition of research for RPA purposes in Recital 28 of the MiFID II Delegated Directive (C(2016)2031) in concluding that corporate access visits do not appear to be "research" and should be considered a discrete service.
- ESMA points out that this does not preclude corporate access visits being paid for from a Research Payments Account (RPA), but general research payments should not subsidise such a service.
- ESMA expects investment firms to carefully assess whether corporate access services such as field trips, conferences and individual meetings involving a corporate issuer and facilitated by an investment firm are material benefits, or alternatively could qualify as an acceptable minor non-monetary benefit.

- ESMA notes that an investment firm can also treat corporate access as a commercial service and pay for it appropriately from its own resources. In such cases, it is important that the provider prices services at commercial levels and access itself is not linked to or dependent on payments for research or execution services where the provider offers these other MiFID services.
- ESMA also notes that the investment firms wishing to meet with a corporate issuer individually has the option to approach them directly and/or pay for a third party corporate access service provider to facilitate meetings that does not provide other MiFID investment services.

#### Macro-economic research (Question 8)

- ESMA draws out two criteria for macro-economic research to fulfil to be considered research, drawn from Recital 28 of the Delegated Directive. These two criteria must both be met:
  1. The material or service must concern one or several financial instruments or other assets, or current or potential issuers of financial instruments, or be closely related to a specific sector or market such that it informs views on financial instruments, assets or issuers within that sector or market; and
  2. The material or service explicitly or implicitly recommends or suggests an investment strategy and provide a substantiated opinion as to the present or future value or price of such instruments or assets, or contains analysis and original insights and reaches 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.
- ESMA thinks that most macro-economic research is likely to suggest an investment strategy, but accepts that some macro-economic research is sufficiently general to fall outside the definition.
- However, if macro-economic analysis is not considered as research according to these criteria, recipients still cannot automatically classify it as a minor non-monetary benefit, because it may be considered substantive or to have material value.
- An important exception is where a provider makes macro-economic-related material openly available at the same time to any investment firms wishing to receive it or to the public, for example on a website. Material made available in this way could be justified as a minor non-monetary benefit – representing “information ... relating to a financial instrument or investment service” that is “generic in nature”.
- Because macro-economic research is often generic it is usually relevant across a variety of strategies and asset allocation decisions, and therefore ESMA thinks that firms 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.

#### FICC research (Question 9)

- ESMA notes that there is no carve-out from the research rules for FICC markets.
- ESMA acknowledges that the lack of explicit execution commission arrangements in FICC markets makes it difficult for firms to pay for FICC research separately from execution costs.

But ESMA thinks that firms may simply choose to pay for such research out of their own resources or by using a RPA funded by a direct charge to the client.

- Given commonalities between FICC and macro research, ESMA believes that firms can use a subscription model to pay for FICC research (as per ESMA's answer to Question 8). But firms must document how they arrive at their pricing structure to avoid the possibility that the research acts as an inducement (i.e. the subscription should not be extremely heavily discounted, for instance).
- As per macro-economic research, FICC research can be made available to the public by providers, or firms may receive FICC research if it has been commissioned and paid for by a corporate issuer or a potential issuer. In both cases the output would be classified as a minor non-monetary benefit.
- ESMA acknowledges that some FICC research may lack enough substantive analysis and instead represent information about financial instruments or short-term market commentary that qualifies as a minor non-monetary benefit.

#### Allocation of research budgets (Question 10)

- ESMA reminds readers that MiFID requires firms to set out in their research policy the criteria against which the quality of the research material they purchase should be assessed. The research policy also needs to articulate how the research inputs can contribute to better investment decisions and explain how the related costs can be allocated in a manner that is fair to the various clients' portfolios.
- ESMA particularly draws attention to the importance of fair allocation of costs to clients where firms purchase research centrally and make it widely available within the firm.
- Fair allocation could involve apportioning costs according to the expected relevance of research to particular investment strategies or the level of use by individuals or teams that manage or advise on certain portfolios or accounts.
- ESMA stresses that the research budget should be an ex-ante estimate of forecast expenditure for research costs that can be charged to portfolios with similar strategies under management. This, in turn, will require that a budget is sufficiently granular to be able to be pre-apportioned by portfolio or client.
- ESMA expects portfolio managers to have robust systems in place to ensure that decisions on the procurement of research are clearly documented, and are taken separately and distinctly from decisions on the choice of brokerage and execution services subject to relevant best-execution requirements. Portfolio managers should be particularly aware of conflicts of interest risks when purchasing research alongside execution services
- In ESMA's view, a firm should have a clear methodology to establish what they expect to pay providers for research before they receive and consume services. One way of doing it is for a firm to set measurable ex ante criteria as to how it will value the types, level and quality of service.
- In order to assess the value of research, ESMA says that firms may, for example, have its own internal 'rate cards' or thresholds to adjust what it will pay individual providers for specified service levels.
- ESMA considers that the regular ex-post assessment contributes to evaluate the quality of the research they have purchased and to inform their future procurement decisions and payment levels.

- ESMA acknowledges that firms have scope to negotiate research prices with suppliers. Internal records of investment firms procuring research should demonstrate how they have reached their assessment of value and the actual price they secure for specific research services. ESMA stresses that there should be no correlation between the transaction volumes executed by a broker on behalf of a portfolio manager and any 'discount' applied to the research material offered to the same portfolio manager.

#### Disclosure of research costs to end-clients (Question 11)

- Before providing an investment service, investment firms intending to use an RPA to pay for investment research should provide clients with two separate pieces of information: (i) the amount that the investment firm has budgeted for research; and (ii) the estimated amount that can be expected to be paid out of the assets of the individual client.
- In relation to the second aspect, ESMA states that the estimate should be considered in light of the wider MiFID II costs and charges provisions. Therefore, ESMA considers that the estimated client research charge should be presented as a single estimate figure, and disclosed in both a percentage (or basis points) format and as a cash amount.
- ESMA allows that if a firm wishes to do so to provide a degree of certainty to investors, it can present (ii) as a maximum figure where they guarantee to their clients they will not pay more than that predetermined amount. However, figures presented as a range are not acceptable.

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