Working Party on Financial Services and the Banking Union

Retail Investment Strategy

18 and 19 March 2024

Presidency discussion paper on inducements

Executive Summary

The progress report by the Spanish Presidency points out that Member States (MS) expressed diverging views on the partial ban on inducements for non-advised sales, ranging from the rejection of any ban to the support for a full ban. Most MS were in favour of further assessing how to better regulate inducements. The extension of the review clause to at least five years gathered broad support from MS. The Spanish Presidency concluded that further discussions are needed to explore the way forward for the partial ban on inducements.

Based on the comments of MS, the Belgian Presidency (Presidency) developed an alternative proposal on inducements, which it presents in this paper for discussion. This proposal is based on the following principles:

- **the adoption of a risk-based approach, by limiting the partial ban on inducements for non-advised sales to complex products only. The Presidency proposes using the existing notion of complexity from the current MiFID and IDD texts;**
- **the introduction of a new inducements test that needs to be complied with when paying or receiving inducements, containing a list of objective criteria that firms need to take into account when assessing the acceptability of these inducements, including a register of inducements. The new inducements test would replace the current 'quality enhancement test' in MiFID and 'no detriment test' in IDD;**
- **the creation of a further level playing field between MiFID and IDD.**

The Presidency also proposes that some adjustments be made to certain Articles of MiFID to further align the inducements framework for portfolio managers with that for independent advisors.

Furthermore, transparency on inducements by means of disclosures on the existence, nature and amount of third-party payment(s) related to the products or services remains crucial.

Regarding the 'best interest of the client test' included in the Commission's proposal, the Presidency takes the view that the criteria in the proposed best interest test for investment advice are interrelated to elements of the existing suitability test in MiFID and IDD. Several criteria of the best interest test are aligned with the current MiFID II Level 2 requirements on suitability. The Presidency therefore proposes tackling aspects of the best interest test (appropriate range, cost efficiency and additional features) within the context of suitability and with the goal of reinforcing the suitability framework at Level 1.

The Presidency also proposes that the rules on investment research be deleted, given that they are covered by the political agreement reached on the Listing Act. Finally, the Presidency proposes that the review clause be extended to five years.

Preliminary remarks

1. **The term "firms" in this discussion paper refers to "investment firms", "insurance undertakings" and "insurance intermediaries" unless explicitly stated otherwise.**

2. **The term "products" in this discussion paper refers to "financial instruments" (MiFID) and "insurance-based investment products" - "IBIPs" (IDD).**

3. **The term "clients" in this discussion paper refers to "retail clients" (MiFID) and "customers" (IDD).**

4. **The term "independent advice" in this discussion paper refers to "advice on a independent basis" (IDD) and "independent investment advice" (MiFID).**

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1. Partial ban on inducements for non-advised services for complex products

1.1. Scope of the partial ban

The Presidency considered the remarks of the different MS regarding the partial ban on inducements for non-advised services to clients. In order to reach a compromise, the Presidency suggests limiting the partial ban to non-advised services for complex products[1], for the following reasons:

- Complex products generally involve higher risks and potential losses for clients. If a firm offers these products without advice and receives inducements from a third party for the distribution of such products, this increases the risk of client detriment. The distributors will need to conduct an appropriateness assessment, the result of which does not prohibit these firms from distributing these products to clients if the client explicitly confirms that it wants to proceed with the transaction. This creates a conflict of interest that can lead to important detrimental consequences for clients.
- Complexity is a concept already used in MiFID[2] and IDD[3].

This proposal would have limited impact on existing distribution systems and would remove any incentive for firms to give more prominence to products with structures that are often very difficult for clients to understand. In addition, an enhanced inducements test (see point 2) would be introduced for execution-only services in non-complex products as a mitigating measure for receiving and paying inducements. The effectiveness of these different measures can then be evaluated in the context of the review of the Omnibus Directive (see point 7).

Q1: Do MS agree on the way forward proposed by the Presidency (i.e. limiting the partial ban to complex products)? If not, MS are invited to explain their objections and to indicate what alternative(s) they suggest, taking into account the goals of the proposal?

1.2. Exemptions to a partial ban

1.2.1. Execution or reception and transmission of orders (RTO) in financial instruments in relation to (non-independent) advice to the same client

The proposed Article 24a(3) of MiFID clarifies that the ban on inducements in

[1] The term 'complexity' is not to be confused with that of 'particularly complex products' as used in the context of disclosures.

[2] Art. 24(4)(a) of MiFID and Art. 57 of Delegated Regulation 2017/565.

[3] Art. 30(3)(a) of IDD and Art. 16 of Delegated Regulation 2017/2359.

relation to the services of execution of orders and reception and transmission of orders does not apply to situations where investment firms provide advice to the same client relating to one or more transactions covered by that advice.

Some MS expressed concerns on how it could be demonstrated that a transaction is covered by the provision of advice. The Presidency therefore suggests adding an explicit reference to the investment recommendations as mentioned in the suitability report. The suitability report must contain the advice given on the specific financial instrument(s) by the firm to clients. If the same investment firm subsequently (and within a reasonable time frame) executes or transmits for execution the transactions that relate to the specific financial instrument(s) that have been advised, then the link between the transaction executed and the advice can be demonstrated (and documented) through the suitability report. This clarification could be added in recital 4 of the Omnibus Directive and/or in Article 24a(3) of MiFID .

1.2.2. Execution or reception and transmission of orders (RTO) in financial instruments linked to underwriting or placement services by the same firm

The proposed Article 24a(4) of MiFID clarifies that the ban on inducements in relation to the services of execution of orders and RTO is not applicable to fees or any other remuneration received from or paid to an issuer by an investment firm when performing underwriting or placement services (with or without a firm commitment) where the same investment firm also provides execution services or RTO to retail clients with regard to the financial instruments subject to the placing or underwriting. The exemption does not apply to instruments that qualify as packaged retail investment products (PRIIPs).

Based on the comments received, the Presidency suggests replacing the term 'remuneration' with the term 'benefit' to avoid any confusion with the notion of remuneration to relevant persons.

One MS asked why the exemption for underwriting and placement services does not apply to financial instruments that are PRIIPs. The Presidency recalls that some PRIIPs (e.g. structured products) are distributed only in the primary market and that there is no real secondary market for such products. The Presidency takes the view that these products should fall under the partial ban and that the exclusion of PRIIPs from the exemption for underwriting and placement services should thus remain. This rationale could be added in recital 4 of the Omnibus Directive as suggested by the aforementioned MS.

Q2: Do MS support the proposed clarifications on the exemptions?

2. New 'inducements test' in MiFID and IDD for sales not covered by a ban

2.1. Introduction of a new 'inducements test'

The Commission has, in its proposal, introduced a 'best interest of the client test' in MiFID and IDD, in addition to the current framework on suitability and taking into account the proposal for a partial ban on inducements for non-advised services. The proposed criteria for the 'best interest of the client test' are interrelated to suitability aspects in the context of investment advice. Furthermore, they do not fully replace the exitsting initial aim of the 'quality enhancement test' (MiFID)[4] and of the 'no detriment test' (IDD)[5] under the current regime.

Given its alternative proposal to limit the partial ban to complex products, the Presidency considers that there is a need to introduce a new inducements test to avoid a regulatory gap in situations where firms are receiving or paying inducements.

The Presidency supports the Commission's goals of (i) limiting conflicts of interest as far as possible and (ii) ensuring that firms act in the best interest of the client. The Presidency therefore suggests that the 'appropriate range of products', 'cost-efficiency' and 'products without additional features' should be incorporated in the suitability framework at Level 1 and be based on concepts which already exist in the MiFID Level 2 texts.

2.1. Criteria of the new 'inducements test'

As explained above, the Presidency proposes that a new **inducements test** be introduced that firms should perform before accepting and retaining or paying inducements in the context of non-independent advice or non-advised sales of non-complex products. This new test would replace the current quality enhancement test in MiFID and the no detriment test in IDD and should contain clear and objective criteria. It is important that the criteria are sufficiently clear to allow for supervision and enforcement by NCAs. Therefore, the Presidency proposes that this inducements test and its main criteria are part of the Level 1 text. The criteria set out below are based mainly on existing Level 2 and Level 3 texts from MiFID or IDD, as well as on supervisory experience. Bringing these criteria together creates a stronger set of rules and ensures alignment between MiFID and IDD. Some of these criteria can be further elaborated at Level 2.

In addition to the inducements test, firms must at all times respect the following **overarching principles** when accepting and retaining or paying inducements from or to a third party:

[4] Art. 11(2) of Commission Delegated Directive (EU) 2017/593.

[5] Art. 8 (2) of Commission Delegated Regulation (EU) 2017/2359.

– The reception or payment of commissions, fees or benefits does not impair compliance with the duty of the firm to act honestly, fairly and professionally in accordance with the best interest of its clients.

– The fee, commission or non-monetary benefit does not provide an incentive to the firm to offer or recommend a particular product or service to the client when a different product or service would better meet the client's needs[6].

– The amount of the fee, commission or the value of the non-monetary benefit is not disproportionate to the nature, extent and value of the services provided to the client (to facilitate the understanding of this general principle and to ensure convergence, this needs to be further detailed by Level 2 measures).

– The firm must apply the same (internal) procedures to all fees, commissions or non-monetary benefits, whether the paying and receiving entities belong to the same group or not[7].

A fee, commission or non-monetary benefit shall be considered not to impair compliance with the firm's duty to act honestly, fairly and professionally in accordance with the best interest of its clients if **all of the following criteria are met**:

a) the fee, commission or non-monetary benefit is not predominantly based on quantitative commercial criteria[8], but also takes into account appropriate qualitative criteria, reflecting compliance with applicable regulations, the quality of services provided to clients and client satisfaction (e.g. cancellation/lapse rate of the product)[9];

b) the fee, commission or non-monetary benefit is not paid in advance[10];

c) the fee, commission or non-monetary benefit is linked to a product for which the firm[11] can demonstrate, in accordance with the product governance requirements, that it meets the best interest of the client (e.g. identification of clients' need, scenario analysis and cost structure);

d) the fee, commission or non-monetary benefit can be reclaimed in nominal value, at least, in case the interests of the clients have been harmed[12];

6 Based on Art. 8(2)(a) of Commission Delegated Regulation (EU) 2017/2359.

7 Based on CESR, *Inducements under MiFID*, CESR/07-228b, General Recommendation 1(b).

8 These qualitative criteria could be further elaborated in Level 2 provisions.

9 Art. 8(2)(b) of Commission Delegated Regulation (EU) 2017/2359.

10 Based on supervisory experience.

11 Where necessary, distributors can request this information from manufacturers based on the product governance requirements in MiFID and IDD.

12 Based on Art. 8(2)(e) of Commission Delegated Regulation (EU) 2017/2359.

e) the fee, commission or non-monetary benefit does not contain any form of variable or contingent threshold or any other kind of value accelerator which is unlocked by attaining a target based on volume or value of sales (e.g. graduated commissions)[13];

f) the fee, commission or non-monetary benefit uses a clear and comprehensible calculation method[14];

g) the fee, commission or non-monetary benefit can be identified separately from other fees, commissions or non-monetary benefits (such as fees relating to services for other clients) and payments or benefits indispensable for the provision of investment services or insurance distribution services[15,16].

Firms must fulfil the requirements set out above on an ongoing basis as long as they continue to pay or accept and retain the fee, commission or non-monetary benefit.

Firms shall hold evidence of the fees[17], commissions or non-monetary benefits paid or received by the firm:

a) by keeping an internal list of all fees, commissions and non-monetary benefits paid or received by the firm from a third party in relation to the provision of investment or ancillary services (MiFID) or manufacturing and/or distribution of IBIPs (IDD); and[18]

b) by recording a detailed analysis as to how the fees, commissions and non-monetary benefits paid or accepted and retained by the firm, or that it intends to use, do not impair compliance with its duty to act honestly, fairly and professionally in accordance with the best interest of its clients. Firms need to keep records of the detailed analysis.

Q3: Do MS agree on the way forward proposed by the Presidency (i.e. introduction of a new inducements test)? If not, MS are invited to explain their objections and to indicate what alternative(s) they suggest, taking into account the goals of the proposal?

Q4: Do MS believe that other specific criteria should be included in the inducements test and if so, which are they?

[13] Based on Art. 8 (2) (f) of Commission Delegated Regulation (EU) 2017/2359.

[14] Based on ESMA, Questions and answers on MiFID II and MiFIR investor protection and intermediaries topics, ESMA35-43-349, Q12.3.

[15] Examples of these indispensable payments and benefits are the fees and costs referred to in Article 24a(7), last paragraph of MiFID and article 29a(1), last paragraph of IDD.

[16] Based on ESMA, Questions and answers on MiFID II and MiFIR investor protection and intermediaries topics, ESMA35-43-349, Q12.3.

[17] Art. 11 (4) of Commission Delegated Directive (EU) 2017/593.

[18] This list includes the fees, commissions and non-monetary benefits that the firm has accepted, but did no retain.

3. Full ban on inducements in case of portfolio management[19] and independent advice[20] services

3.1. "Received" versus "accepted and retained" fees and commissions for portfolio management

The proposed Article 24a(1) of MiFID stipulates that investment firms, when providing portfolio management, **do not pay or receive** any fee or commission, or provide or are provided with any non-monetary benefit, in connection with the provision of such service, to or by any party except the client or a person on behalf of the client.

Several MS expressed the view that the wording of the ban on inducements for portfolio management and independent advice should remain as in the current Directive 2014/65/EU: *When providing portfolio management the investment firms shall **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.* This would mean that investment firms can still accept inducements in all situations which fall under the inducements ban as long as they do not retain them but pass them on to the client in full as soon as possible after receipt of these payments. This is clarified in the current recital 74 of MiFID (Directive 2014/65/EU).

The Presidency suggests the wording of the new Article 24a(1) of MiFID to be changed to "*do not pay or **accept and retain***" in order to avoid a costly impact for firms that may have to modify their existing products (e.g. need to establish new rebate free share class funds) or business models (e.g. no longer possible to pass the inducements through), whilst the benefit for the client of the wording proposed by the Commission seems to be limited. Furthermore, this would align the text with Article 24(7) of MiFID for investment firms providing investment advice on an independent basis.

Q5: Do MS support changing the wording of the inducements ban for portfolio management to "do not pay or accept and retain"? If not, please explain.

3.2. Scope of ban for portfolio management and independent advice

MS generally expressed support for the ban on inducements for portfolio management services (proposed Article 24a(1) of MiFID replacing current Article 24(8) of MiFID). The Presidency notes that there is an asymmetrical treatment of portfolio managers and independent advisors in the Commission's proposal: portfolio managers cannot pay or

[19] Art. 24a (1) of MiFID.

[20] Art. 24 (7) (b) of MiFID and Art. 30 (5b) of IDD.

receive any fee, commission or benefit, whilst independent advisors[21] are prohibited only from accepting and retaining fees, commissions or benefits.

The Presidency believes that there is no rationale for allowing independent advisors to pay inducements to third parties. Moreover, the fact that independent advisors are allowed to pay inducements to third parties could compromise their necessary independence.

The Presidency suggests having a level playing field between portfolio managers and independent advisors. This means that a ban on paid or accepted and retained inducements should also apply to independent advisors. A similar ban should apply to insurance undertakings and insurance intermediaries when they provide advice on an independent basis.

Furthermore, some MS expressed concerns about the differentiation introduced in Article 30(5b) of IDD between advice given on an independent and a non-independent basis. This could have an impact on insurance intermediaries that are not employed by or contractually tied to an insurance undertaking, but are remunerated by a fee or a commission. The Commission addressed this concern in its Explanatory Memorandum[22].

The Presidency suggests supplementing the proposed Article 30(5b) of IDD with the following paragraph: "*This paragraph shall not prevent insurance intermediaries that are not employed by or contractually tied to an insurance undertaking, but receive fees, commissions and non-monetary benefits from the insurance undertaking and that fall within the scope of Article 29a IDD ('inducements'), from presenting themselves as not contractually tied to a specific insurance undertaking.*"

Q6: Do MS support having a level playing field between portfolio managers and independent advisors with regard to the ban on payment of inducements? If not, please explain.

[21] Art. 24 (7) of MiFID.

[22] COM(2023) 279 final, p. 16: "*Specifically in relation to IDD, Article 2(22), point (d) strengthens the safeguards for advice in Article 30(5b), and introduces a differentiation between advice given on an independent and non-independent basis in alignment with MiFID, if insurance intermediaries want to present their advice as 'independent'. It does so by making the independent basis category compulsory instead of optional for Member States, and by banning the reception or the provision of inducements in relation to advice given on an independent basis. However, such a ban should not prevent insurance intermediaries from offering advice for which they may receive inducements, provided that the advice is not presented as 'independent' and retail customers are informed of the inducements in line with applicable transparency requirements. In view of the diversity of the insurance distribution structures in the Member States, it should also not prevent insurance intermediaries that are not employed by or contractually tied to an insurance undertaking but receive inducements from presenting themselves as not contractually tied to a specific insurance undertaking.*"

4. Possibility of imposing additional requirements by MS (MiFID)

The Spanish Presidency indicated in its final non-paper of 27 December 2023 containing drafting suggestions regarding the Omnibus Directive, that MS have expressed broad support for the amendment to the proposed Article 24(12) of MiFID in order to specify the cases in which MS may impose additional requirements on investment firms. One MS however suggested deleting the term 'in exceptional cases', considering that such term creates uncertainties and debates regarding the circumstances allowing MS to go beyond the rules set in those articles. It appears to be problematic to delete that term as the imposition of additional requirements should be the exception and not the common practice in this field.

Based on these considerations, the Presidency is of the opinion that Article 24(12) of MiFID can be kept as amended by the Spanish Presidency (see those amendments marked in **bold blue** hereafter), without further amendments:

Article 24

General principles and information to clients

[…]

12. Member States may**,** in exceptional cases**,** impose additional requirements on investment firms in respect of the matters covered by this Article **and Articles 24a, 24b, 24c**. Such requirements must be objectively justified and proportionate so as to address specific risks to investor protection or to market integrity which are of particular importance in the circumstances of the market structure of that Member State.

Except when Member States already notified the Commission about such additional requirements before the date of entry into force of the Directive, Member States shall notify the Commission of any requirement which they intend to impose in accordance with this paragraph without undue delay and at least two months before the date appointed for that requirement to come into force. The notification shall include a justification for that requirement. Any such additional requirements shall not restrict or otherwise affect the rights of investment firms under Articles 34 and 35 of this Directive. […]

Q7: Do MS agree to keep Article 24(12) of MiFID as amended by the Spanish Presidency?

5. General exemption for minor non-monetary benefits

Proposed Articles 24a (5) of MiFID and 29a (1) of IDD state that the partial ban on inducements and the ban on inducements in portfolio management shall not apply to minor non-monetary benefits of a total value below EUR 100 per annum or of a scale and nature such that they could not be judged to impair compliance with the firm's duty to act in the best interest of the client, provided that they have been clearly disclosed to the client.

Several MS indicated that the exemption for minor non-monetary benefits needs clarification on how the threshold of EUR 100 should be read in combination with the qualitative limit. The current wording may lead to different interpretations.

The Presidency points out that in MiFID only the 'de minimis' rule of EUR 100 euro per annum is new. The current Article 12 (3) of MiFID Delegated Directive 2017/593 already contains a limitative list of non-monetary benefits which could qualify as *acceptable* non-monetary benefits[23]. For IDD, however, the concept of minor non-monetary benefits is new.

The Presidency proposes that Recital 4 of the Omnibus Directive be clarified by explaining that non-monetary benefits of a value of EUR 100 or less per year automatically qualify as acceptable minor non-monetary benefits and do not require any further assessment. However, if the value of the non-monetary benefit exceeds EUR 100 per annum, then a further assessment of the scale and nature should be performed. The Presidency believes that this assessment should be detailed by Level 2 provisions.

Furthermore, Article 24a (5) of MiFID on minor non-monetary benefits refers only to paragraphs 1 and 2 of the proposed Article 24a (ban on inducements for portfolio management and partial ban for non-advised services) and therefore excludes

[23] (a) 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;

(b) 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;

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

(d) 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 point (c); and

(e) other minor non-monetary benefits which a Member States 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.

independent advisors. For the sake of consistency, the Presidency suggests amending Article 24 (7) of MiFID in order to apply the limit of EUR 100 to independent advisors as well.

Q8: Do MS support the way forward proposed by the Presidency with regard to minor non-monetary benefits? If not, please explain.

5. Transparency on inducements

Article 24a (7) of MiFID indicates that where applicable, the investment firm shall inform the client about the mechanisms for transferring to the client the fee, commission, monetary or non-monetary benefit received in relation to the provision of the investment or ancillary service. This is not provided for Article 29a (2) of IDD, although there can be situations (e.g. independent advice) where an insurance undertaking or insurance intermediary receives inducements, but may not or does not want to retain them (see Section 3.2 of this discussion paper). Therefore, the Presidency suggests adding a similar paragraph to Article 29a (2) of IDD in order to further align IDD with MiFID.

Those articles further specify that the existence, nature and amount of third-party payment(s) related to the products or services should be disclosed in accordance with, respectively, Article 24b (1) of MiFID and Article 29 of IDD.

Q9: Do MS agree to the addition of a paragraph in Article 29a (2) of IDD to align the transparency requirements with those provided for MiFID? If not, please explain.

6. Investment research

Several MS indicated that the specific rules for the provision of research by third parties have been superseded by the political agreement that was reached on the Listing Act. The Presidency therefore proposes that Article 24a(6) be deleted from the Commission proposal and paragraph 9a of Article 24 of MiFID be retained as amended by the Listing Act[24].

Q10: Do MS agree to the deletion of paragraph 6 of the Article 24a proposed by the Commission? If not, please explain.

[24] The proposed deletion of Article 9a of MIFID in the Commission proposal should also be removed for that same reason.

7. Review clause

The Commission's proposal includes, in Articles 24a(8) of MiFID and 29a(6) of IDD, a review clause requiring the Commission to assess the effects of third-party payments on retail investors three years after the entry into force of the Omnibus Directive, to evaluate the impact of the new requirements.

The Spanish Presidency indicated in its progress report that the extension of the review clause to at least five years seemed to gather enough support from delegations. Most MS indicated that a review clause of three years after the entry into force of the Omnibus Directive is too short.

The Presidency therefore proposes that the review clause be amended accordingly, i.e. to provide for a review five (and not three) years after the entry into force of the Omnibus Directive.

Q11: Do MS support the amendment to the review clause so that the review takes place five (and not three) years after the entry into force of the Omnibus Directive? If not, please explain.