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DIRECTIVE DI87-01

OF THE CYPRUS SECURITIES AND EXCHANGE COMMISSION FOR THE 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

In replacement of Directive D87-01 (R.A.D. 360/2017)

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PART I  
INTRODUCTORY PROVISIONS

87(I) of 2017	The Cyprus Securities and Exchange Commission, in accordance with the powers vested in it by virtue of section 96 of the Investment Services and Activities and Regulated Markets Law of 2017, and for the purpose of harmonisation with the Commission Delegated Directive (EU) 2017/593 of the European Commission of 7 April 2016 supplementing Directive 2014/65/EE 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, issues the following Directive:
Official Journal, L87, 31.3.2017, p.500	
Short Title	1. This Directive will be cited as the Directive for the Safeguarding of Client Assets, Product Governance Obligations and Inducements.
Definitions	2. For the purpose of this Directive, unless the context shall prescribe otherwise:  "qualifying money market fund", means a collective investment undertaking authorised under Directive 2009/65/EC, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), or which is subject to supervision and, if applicable, authorised by an authority under the national law of the authorising Member State, and which satisfies all of 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.
Official Journal L302, 17.11.2009, p.32	
56(I)/2013 8(I)/2015 97(I)/2015	"AIFM of the Republic" has the meaning assigned to it by section 2 (1) of the Alternative Investment Fund Managers Law;

78(I) of 2012  
88(I) of 2015  
52(I) of 2016

“UCITS management company” has the meaning assigned to the term “Management Company” in section 2(1) of the of the Open-ended Undertakings for Collective Investments in Transferable Securities (UCITS) and Related Issues Law, of which its Member State is the Republic;

Official Journal: L  
173,12.6.2014,  
p. 349

“Directive 2014/65/EU” means the act of the European Union titled “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”, as last amended by Directive (EU) 2016/1034 of the European Parliament and of the Council of 23 June 2016;

Official Journal: L  
337, 23.12.2015,  
p. 35

“securities financing transaction” means the transactions as defined in Article 3 point (11) of Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse;

“Law” means the Investment Services and Activities and Regulated Markets Law of 2017;

Without prejudice to the abovementioned provisions, terms used in this Directive that are not interpreted differently shall have the meaning given to them by the Law.

Where in the present Directive reference is made to the Law, it also means the delegated directives issued by it and any other relevant European Union act.

Purpose and Scope 3. (1) This Directive determines and specifies the provisions of sections 17 και 25 of the Law with regard to the organisational obligations, and the general principles and information to clients, accordingly.

78(I)/2012  
88(I)/2015  
52(I)/2016

(2) This Directive applies to CIFs, Management Companies in accordance with section 109(6) of the Open-ended Undertakings for Collective Investments in Transferable Securities (UCITS) and Related Issues Law, AIFMs in accordance with section 6(8) of the Alternative Investment Managers Law.

56(I)/2013  
8(I)/2015  
97(I)/2015

## PART II SAFEGUARDING OF CLIENT FINANCIAL INSTRUMENTS AND FUNDS

Safeguarding of  
client financial  
instruments and  
funds

4. (1) The CIF complies with the following requirements:

- a) The CIF must keep records and accounts so as to enable the CIF at any time and without delay to distinguish assets held for one client from assets held for any other client, as well as from the CIF’s own assets;
- b) The CIF must maintain its records and accounts in a way that ensures their accuracy, and in particular their correspondence to the financial

instruments and funds held for clients as well as that they can be used as an audit trail;

- c) The CIF must conduct, on a regular basis, reconciliations between its internal accounts and records and those of any third parties by whom those assets are held;
- d) The CIF must take the necessary steps to ensure that any client financial instruments deposited with a third party, in accordance with Paragraph 5, are identifiable separately from the financial instruments belonging to the CIF and from financial instruments belonging to that third party, by means of differently titled accounts on the books of the third party or by other equivalent measures that achieve the same level of protection;
- e) The CIF must take the necessary steps to ensure that client funds deposited, in accordance with Paragraph 6, 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 CIF;
- f) The CIF must introduce adequate organisational arrangements in order 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 related to the applicable law, including in particular the law relating to property or insolvency, the CIF cannot comply with the requirements of sub-paragraph 1 for the safeguarding of clients' rights regarding compliance with sections 17(8) and (9) of the Law, then the CIF shall put in place arrangements to ensure that clients' assets are safeguarded, in order to meet the objectives of sub-paragraph 1.

(3) If the applicable law of the jurisdiction in which the client funds or financial instruments are held, prevents the CIF from complying with points (d) or (e) of sub-paragraph 1, the Commission shall prescribe requirements with equivalent effect in terms of safeguarding clients' rights.

The CIF, when relying on such equivalent requirements under sub-paragraph (1)(d) or (e), shall inform its clients that in such instances they do not benefit from the provisions envisaged under the Law and this Directive.

(4) The CIF shall ensure that security interests, liens or rights of set-off over client financial instruments or funds which enable third parties to dispose of the 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 are not permitted except where this is required by the applicable law in a third country jurisdiction in which the client funds or financial instruments are held.

The CIF must, when entering into agreements that create such security interests, liens or rights of set-off, disclose that information to clients indicating to them the risks associated with those arrangements.

Where security interests, liens or rights of set-off are provided by the CIF over client financial instruments or funds, or where the CIF has been informed that

they have been provided, then these must be recorded in client contracts and to the CIF's own accounts in order to make the ownership status of the client's assets clear, such as in the event of an insolvency.

(5) The CIF must make information pertaining to clients' financial instruments and funds readily available to the competent authorities, appointed insolvency practitioners and those responsible for the resolution of failed institutions. The information to be made available shall include the following:

- a) related internal accounts and records that readily identify the balances of funds and financial instruments held for each client;
- b) where client funds are held by the CIF in accordance with paragraph 6, details on the accounts in which client funds are held and on the relevant agreements with those firms;
- c) where financial instruments are held by the CIF in accordance with paragraph 5, details on the accounts opened with third parties and on the relevant agreements with those third parties, as well as details on the relevant agreements with the CIF;
- d) details of third parties carrying out any related (outsourced) tasks and details of any outsourced tasks;
- e) key individuals of the CIF which are involved in related processes, including those responsible for the oversight of the firm's requirements in relation to the safeguarding of client assets;
- f) agreements relevant to the establishment of client ownership over the assets.

Depositing client  
financial instruments

5. (1) The CIF may deposit financial instruments held by the CIF on behalf of its clients into an account or accounts opened with a third party provided that the CIF exercises 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, the CIF must 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) The CIF may deposit client financial instruments with a third party, only where the third party is established in a jurisdiction where the safekeeping of financial instruments for the account of another person is subject to specific regulation and supervision and that third party is subject to this specific regulation and supervision.

(3) The CIF is not allowed to deposit financial instruments held on behalf of clients with a third party established 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 established in that third country;

- b) where the financial instruments are held on behalf of a professional client, that client has requested the CIF in writing to deposit them with a third party in that third country.

(4) The requirements of sub-paragraphs (2) και (3) shall also apply when the third-party has delegated any of its functions concerning the holding and safekeeping of financial instruments to another third-party.

Depositing client funds

6. (1) The CIF must, upon receiving any client funds, promptly place those funds into one or more accounts opened with any of the following:

- a) central bank;
- b) credit institution as defined in article 2(1) of the Business of Credit Institutions Law;
- c) bank authorised in a third country;
- d) qualifying money market fund.

66(I)/1997  
74(I)/1999  
94(I)/2000  
119(I)/2003  
4(I)/2004  
151(I)/2004  
231(I)/2004  
235(I)/2004  
20(I)/2005  
80(I)/2008  
100(I)/2009  
123(I)/2009  
27(I)/2011  
104(I)/2011  
107(I)/2012  
14(I)/2013  
87(I)/2013  
102(I)/2013  
141(I)/2013  
5(I)/2015  
26(I)/2015  
35(I)/2015  
71(I)/2015  
93(I)/2015  
109(I)/2015  
152(I)/2015  
168(I)/2015  
21(I)/2016  
5(I) of 2017

This shall not apply to a credit institution authorised under the Business of Credit Institutions Law in relation to deposits within the meaning of this Directive, which are held by those credit institutions.

(2) Where the CIF does not deposit client funds with a central bank, the CIF 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 take into consideration the need for diversification of these funds as part of the required due diligence.

In particular, the CIF must 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 the clients' rights.

The CIF must ensure that clients give their explicit consent to the placement of their funds in a qualifying money market fund. In order to ensure that this right to consent is effective, the CIF inform its clients that funds placed with a qualifying money market fund will not be held in accordance with the requirements for safeguarding client funds, which are set out in this Directive.

(3) Where the CIF deposits client funds with a credit institution, bank or money market fund of the same group as the CIF, then the CIF must limit the funds that are deposited with any such group entity or combination of any such group entities so that the funds do not exceed 20% of all such funds.

The CIF may not comply with this limit where 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 referred to in above, and including in any case the small balance of client funds that the CIF holds, the requirement under the previous sub-paragraph is not proportionate. The CIF periodically reviews the assessment made in accordance with this subparagraph and notifies its initial and revised assessments to the Commission.

Use of client financial instruments

7. (1) The CIF is not allowed to enter into arrangements for securities financing transactions in respect of financial instruments held by the CIF on behalf of a client, or otherwise use such financial instruments for its own account or the account of any other person or client of the CIF, unless both of the following conditions are met:

- a) the client has given his prior express consent for the use of the instruments on specified terms, as evidenced expressly and in writing and affirmatively executed by signature or in an equivalent manner, and
- b) the use of that client's financial instruments is restricted to the specified terms to which the client consents.

(2) The CIF is not allowed to 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 its own account or for the account of any other person unless, in addition to the conditions set out in subparagraph 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 sub-paragraph 1;
- b) the CIF must have in place systems and controls which ensure that only financial instruments belonging to clients who have given their prior express consent in accordance with point (a) of sub-paragraph 1 are used.

The CIF's records 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) The CIF takes appropriate measures to prevent the unauthorised use of client financial instruments for its own account or the account of any other person such as:

- a) the conclusion of agreements with clients on measures to be taken by the CIF in case the client does not have enough 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 CIF of its projected ability to deliver on the settlement date and the putting in place of remedial measures in the event that this cannot be done; and
- c) the close monitoring and prompt request of undelivered securities outstanding on the settlement day and beyond.

(4) The CIF must adopt specific arrangements for all clients to ensure that the borrower of client financial instruments provides the appropriate collateral and that it monitors the continued appropriateness of such collateral and takes the necessary steps to maintain the balance with the value of client instruments.

(5) The CIF does not enter into arrangements which are prohibited under section 17(10) of the Law.

Inappropriate use of title transfer collateral arrangements

8. (1) The CIF properly considers, and is able to demonstrate that it has done so, the use of title transfer collateral arrangements in the context of the relationship between the client's obligation to the CIF and the client assets subjected to title transfer collateral arrangements by the CIF.

(2) When considering, and documenting, the appropriateness of the use of title transfer collateral arrangements, the CIF takes into account all of the following factors:

- a) whether there is only a very weak connection between the client's obligation to the CIF and the use of title transfer collateral arrangements, including whether the likelihood of a clients' liability to the CIF 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 towards the CIF; and
- c) whether all clients' financial instruments or funds are subject to title transfer collateral arrangements, without consideration of what obligation each client has to the CIF.

(3) Where the CIF uses title transfer collateral arrangements, it 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.



Governance arrangements concerning the safeguarding of client assets

9. The CIF appoints a single officer of sufficient skill and authority with specific responsibility for matters relating to the CIF's compliance with its obligations regarding the safeguarding of client financial instruments and funds.

The CIF decides, by ensuring full compliance with this Directive, whether the appointed officer is to be dedicated solely to this task or whether the officer can discharge responsibilities effectively whilst having additional responsibilities.

Reports by external auditors

10. The CIF ensures that its external auditors report at least annually to the Commission on the adequacy of the CIF's arrangements under section 17(8), (9) and (10) of the Law and the provisions of this Chapter.

### PART III PRODUCT GOVERNANCE REQUIREMENTS

Product governance obligations for CIF manufacturing financial instruments

11. (1) The CIF must comply with this paragraph when manufacturing financial instruments, which encompasses the creation, development, issuance and/or design of financial instruments.

The CIF that manufactures financial instruments complies, in a way that is appropriate and proportionate, with the relevant requirements in sub-paragraphs 2 to 15, taking into account the nature of the financial instrument, the investment service and the target market for the product.

(2) The CIF establishes, implements and maintains procedures and measures to ensure that the manufacturing of financial instruments complies with the requirements relating to proper management of conflicts of interest, including remuneration.

In particular, the CIF that manufactures financial instruments, ensures that the design of the financial instrument, including its features, does not adversely affect end clients or does not lead to problems with market integrity by enabling the CIF to mitigate and/or dispose of its own risks or its exposure to the underlying assets of the product, where the CIF already holds the underlying assets on own account.

(3) The CIF analyses potential conflicts of interests each time it manufactures a financial instrument. In particular, the CIF shall assess whether the financial instrument creates a situation where end clients may be adversely affected if they take:

- a) an exposure opposite to the one previously held by the CIF itself; or
- b) an exposure opposite to the one that the CIF wants to hold after the sale of the product.

(4) The CIF examines whether the financial instrument is likely to pose a threat to the orderly functioning or stability of financial markets before deciding to proceed with the launch of the product.

(5) The CIF ensures that the relevant staff involved in the manufacturing of financial instruments possess the necessary expertise to understand the characteristics and risks of the financial instruments it intends to manufacture.

(6) The CIF ensures that the management body has effective control over its product governance process. The CIF ensures that the compliance reports to the management body systematically include information about the financial instruments manufactured by the CIF, including information on the distribution strategy. The CIF makes the reports available to the Commission on request.

(7) The CIF ensures that the compliance function monitors the development and periodic review of product governance arrangements, in order to detect any risk of failure by the CIF to comply with the obligations set out in this paragraph.

(8) Where the CIF collaborates, including with entities which are not authorised and supervised in accordance with Directive 2014/65/EU or third-country firms, in order to create, develop, issue and/or design a product, must outline their mutual responsibilities in a written agreement.

(9) The CIF identifies at a sufficiently detailed level the potential target market for each financial instrument and specify the type(s) of client for whose needs, characteristics and objectives the financial instrument is compatible. As part of this process, the CIF identifies any group(s) of clients for whose needs, characteristics and objectives the financial instrument is not compatible. Where the CIF collaborates to manufacture a financial instrument, only one target market needs to be identified.

The CIF which manufactures financial instruments that are distributed through other investment firms, shall determine the needs and characteristics of clients for whom the product is compatible based on their theoretical knowledge of, and past experience with the financial instrument or similar financial instruments, the financial markets and the needs, characteristics and objectives of potential end clients.

(10) The CIF undertakes a scenario analysis of their financial instruments which shall assess the risks of poor outcomes for end clients posed by the product and in which circumstances these outcomes may occur. The CIF assesses the financial instrument under negative conditions covering what would happen if, for example:

- a) the market environment deteriorated;
- b) the manufacturer or the third party involved in manufacturing and or functioning of the financial instrument experiences financial difficulties or another counterparty risk materialises;
- c) the financial instrument fails to become commercially viable;
- d) the demand for the financial instrument is much higher than anticipated, putting a strain on the CIF's resources and/or on the market of the underlying instrument.

(11) The CIF determines whether a financial instrument meets the identified needs, characteristics and objectives of the target market including, by examining the following elements:

- a) the financial instrument's risk/reward profile is consistent with the target market; and
- b) design of the financial instrument is driven by features that benefit the client and not by a business model that relies on poor client outcomes to be profitable.

(12) The CIF considers the charging structure proposed for the financial instrument, including by examining the following:

- a) the financial instrument's costs and charges are compatible with the needs, objectives and characteristics of the target market;
- b) charges do not undermine the financial instrument's return expectations, such as where the costs or charges equal, exceed or remove almost all the expected tax advantages linked to a financial instrument; and
- c) the charging structure of the financial instrument is appropriately transparent for the target market, such as that it does not disguise charges or is too complex to understand.

(13) The CIF ensures that the provision of information about a financial instrument to distributors includes information about the appropriate channels for distribution of the financial instrument, the product approval process and the target market assessment and is of an adequate standard to enable distributors to understand and recommend or sell the financial instrument properly.

(14) The CIF reviews the financial instruments it manufactures on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. The CIF examines if the financial instrument remains consistent with the needs, characteristics and objectives of the target market and if it is being distributed to the target market, or is reaching clients for whose needs, characteristics and objectives the financial instrument is not compatible.

(15) The CIF reviews the financial instruments prior to any further issue or re-launch, if it is aware of any event that could materially affect the potential risk to investors and at regular intervals to assess whether the financial instruments function as intended. The CIF determines how regularly it will review its financial instruments based on relevant factors, including factors linked to the complexity or the innovative nature of the investment strategies pursued. The CIF also identifies crucial events that would affect the potential risk or return expectations of the financial instrument, such as:

- a) the crossing of a threshold that will affect the return profile of the financial instrument; or
- b) the solvency of certain issuers whose securities or guarantees may impact the performance of the financial instrument.

When such events occur, the CIF takes appropriate actions which may consist of the following:

- a) the provision of any relevant information on the event and its consequences on the financial instrument to the clients or the distributors of the financial instrument if the CIF does not offer or sell the financial instrument directly to the clients;
- b) changing the product approval process;
- c) stopping further issuance of the financial instrument;
- d) changing the financial instrument to avoid unfair contract terms;
- e) examining whether the sales channels through which the financial instruments are sold are appropriate where the CIF becomes aware that the financial instrument is not being sold as envisaged;
- f) contacting the distributor to discuss a modification of the distribution process;
- g) terminating the relationship with the distributor; or
- h) informing the Commission.

Product governance obligations for distributors

12. (1) The CIF, when deciding the range of financial instruments issued by itself or other firms and services it intends to offer or recommend to clients, complies, in a way that is appropriate and proportionate, with the relevant requirements laid down in sub-paragraphs (2) to (10), by taking into account the nature of the financial instrument, the investment service and the target market for the product.

The CIF complies with the requirements of the Law when offering or recommending financial instruments manufactured by entities that are not subject to the Law. As part of this process, the CIF has in place effective arrangements to ensure that it obtains sufficient information about these financial instruments from these manufacturers.

The CIF determines the target market for the respective financial instrument, even if the target market was not defined by the manufacturer.

(2) The CIF has in place adequate product governance arrangements to ensure that products and services it intends to offer or recommend are compatible with the needs, characteristics, and objectives of an identified target market and that the intended distribution strategy is consistent with the identified target market. The CIF identifies and assesses the circumstances and needs of the clients it intends to focus on, so as to ensure that clients' interests are not compromised as a result of commercial or funding pressures. As part of this process, the CIF identifies any groups of clients for whose needs, characteristics and objectives the product or service is not compatible.

The CIF obtains from manufactures that are subject to the Law, information to gain the necessary understanding and knowledge of the products it intends to recommend or sell in order to ensure that these products will be distributed in accordance with the needs, characteristics and objectives of the identified target market.

Official Journal,  
L345, 31.12.2003,  
p.64  
L.390,31.12.2004,  
p.38

The CIF takes all reasonable steps to ensure that it also obtains adequate and reliable information from manufacturers not subject to the Law, to ensure that products will be distributed in accordance with the characteristics, objectives and needs of the target market. Where relevant information is not publicly available, the distributor shall take all reasonable steps to obtain such relevant information from the manufacturer or its agent. Acceptable publicly available information is information which is clear, reliable and produced to meet regulatory requirements, such as disclosure requirements under Directive 2003/71/EC with regard to the prospectus to be published when securities are offered to the public or admitted to trading or 2004/109/EC on the harmonization of transparency requirements for information on issuers whose securities are admitted to trading on a regulated market, of the European Parliament and of the Council. This obligation is relevant for products sold on primary and secondary markets and shall apply in a proportionate manner, depending on the degree to which publicly available information is obtainable and the complexity of the product

The CIF uses the information obtained from manufacturers and information on its own clients to identify the target market and distribution strategy. When the CIF acts both as a manufacturer and a distributor, only one target market assessment shall be required.

(3) The CIF, when deciding the range of financial instrument and services that it offers or recommends and the respective target markets, maintains procedures and measures to ensure compliance with all applicable requirements under the Law including those relating to disclosure, assessment of suitability or appropriateness, inducements and proper management of conflicts of interest. In this context, particular care shall be taken when distributors intend to offer or recommend new products or there are variations to the services they provide.

(4) The CIF periodically reviews and updates its product governance arrangements in order to ensure that they remain robust and fit for their purpose, and take appropriate actions where necessary.

(5) The CIF reviews the investment products it offers or recommends and the services it provides on a regular basis, taking into account any event that could materially affect the potential risk to the identified target market. The CIF assesses, at least, whether the product or service remains consistent with the needs, characteristics and objectives of the identified target market and whether the intended distribution strategy remains appropriate. The CIF re-examines the target market and/or updates the product governance arrangements if it becomes aware that it has wrongly identified the target market for a specific product or service or that the product or service no longer meets the circumstances of the identified target market, such as where the product becomes illiquid or very volatile due to market changes.

(6) The CIF ensures that its compliance function oversees the development and periodic review of product governance arrangements in order to detect any risk of failure to comply with the obligations set out in this paragraph.

(7) The CIF ensures that the relevant staff possess the necessary expertise to understand the characteristics and risks of the products that it intends to offer or recommend and the services provided as well as the needs, characteristics and objectives of the identified target market.

(8) The CIF ensures that the management body has effective control over the CIF's product governance process to determine the range of investment products that it offers or recommends and the services provided to the respective target markets. The CIF ensures that the compliance reports to the management body systematically include information about the products it offers or recommends and the services provided. The compliance reports shall be made available to the Commission, upon request.

(9) The distributors provide manufacturers with information on sales and, where appropriate, information on the above reviews to support product reviews carried out by manufacturers.

(10) Where different entities work together in the distribution of a product or service, the CIF that has direct client relationship has ultimate responsibility to meet the product governance obligations set out in this paragraph. However, the intermediary CIF shall:

- a) ensure that relevant product information is passed from the manufacturer to the final distributor in the chain;
- b) if the manufacturer requires information on product sales in order to comply with its own product governance obligations, enable him to obtain it; and
- c) apply the product governance obligations for manufacturers, as relevant, in relation to the service it provides.

#### PART IV INDUCEMENTS

#### Inducements

13. (1) The CIF who pays or is being paid any fee or commission or providing or being provided with any non-monetary benefit in connection with the provision of an investment service or ancillary service to the client, ensures that all the conditions set out in section 25(9) of the Law and the requirements set out in sub-paragraphs (2)-(5) are met at all times.

(2) A fee, commission or non-monetary benefit shall be considered to be designed to enhance the quality of the relevant service to the client if all of the following conditions are met:

- a) it is 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 non-independent investment advice 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 CIF;
  - ii. the provision of non-independent investment 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 client, including an appropriate number of instruments from third party product providers having no close links with the CIF, together with either 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 it has invested, or providing periodic reports of the performance and costs and charges associated with the financial instruments.
- b) it does not directly benefit the recipient firm, its shareholders or employees without a tangible benefit to the relevant client;
- c) it is justified by the provision of an on-going benefit to the relevant client in relation to an on-going inducement.

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

(3) The CIF fulfils the requirements set out in sub-paragraph (2) on an ongoing basis as long as they continue to pay or receive the fee, commission or non-monetary benefit.

(4) The CIF holds evidence that any fees, commissions or non-monetary benefits paid or received by the CIF are designed to enhance the quality of the relevant service to the client:

- a) by keeping an internal list of all fees, commissions and non-monetary benefits received from a third party in relation to the provision of investment or ancillary services; and
- b) by recording how the fees, commissions and non-monetary benefits paid or received by the CIF, 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 CIF's duty to act honestly, fairly and professionally in accordance with the best interests of its clients.

(5) The CIF discloses to the client, in relation to any payment or benefit received from or paid to third parties, the following information:

- a) prior to the provision of the relevant investment or ancillary service, the CIF discloses to the client information on the payment or benefit concerned in accordance with section 25(9)(b) of the Law. Minor non-monetary benefits may be described in a generic way. Other non-monetary benefits received or paid by the CIF in connection with the investment service provided to a client shall be priced and disclosed separately;
- b) where the CIF is 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 CIF also provides

its clients with information of the exact amount of the payment or benefit received or paid on an ex-post basis; and

- c) at least once a year, as long as (on-going) inducements are received by the CIF in relation to the investment services provided to the relevant clients, the CIF informs its clients on an individual basis about the actual amount of payments or benefits received or paid. Minor non-monetary benefits may be described in a generic way.

The CIF, in implementing these requirements, takes into account the rules on costs and charges set out in section 25(4)(a)(iii) and (b) of the Law and in article 50 of the Commission Delegated Regulation (EU) 2017/565 of the European Parliament and of the Council as regards organisational requirements and operating conditions for CIFs.

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When more firms are involved in a distribution channel, each CIF providing an investment or ancillary service shall comply with its obligations to make disclosures to its clients.

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

14. (1) Where the CIF provides investment advice on an independent basis or portfolio management, returns 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 transferred in full to the client.

The CIF sets up and implements 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.

The CIF informs clients about the fees, commissions or any monetary benefits transferred to them, such as through the periodic reporting statements provided to the client.

(2) The CIF that provides investment advice on an independent basis or portfolio management will not accept non-monetary benefits that do not qualify as acceptable minor non-monetary benefits in accordance with sub-paragraph 3.

(3) The following benefits shall qualify as acceptable minor non-monetary benefits only if they are:

- 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, 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 firm 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 the Commission 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 a CIF's duty to act in the best interest of the client.

Acceptable minor non-monetary benefits are reasonable and proportionate and of such a scale that they are unlikely to influence the CIF's behaviour in any way that is detrimental to the interests of the relevant client.

Disclosure of minor non-monetary benefits are made prior to the provision of the relevant investment or ancillary services to clients. In accordance with paragraph 13(5)(a), minor non-monetary benefits may be described in a generic way.

Inducements in relation to research

15. (1) The provision of research by third parties to a CIF that provides portfolio management or other investment or ancillary services to clients is not regarded as an inducement if it is received in return for either of the following:

- a) direct payments by the CIF out of its own resources;
- b) payments from a separate research payment account controlled by the CIF, provided the following conditions relating to the operation of the account are met:
  - i. the research payment account is funded by a specific research charge to the client;
  - ii. as part of establishing a research payment account and agreeing the research charge with its clients, the CIF sets and regularly assesses a research budget as an internal administrative measure;
  - iii. the CIF is held responsible for the research payment account;
  - iv. the CIF regularly assesses the quality of the research purchased based on robust quality criteria and its ability to contribute to better investment decisions.

With regard to point (b) abovementioned, where the CIF makes use of the research payment account, it shall provide the following information to clients:

- a) information about the budgeted amount for research and the amount of the estimated research charge for each of the client, before the provision of an investment service to them;

- b) annual information on the total costs that each of them has incurred for third party research.

(2) Where the CIF operates a research payment account, upon request by its clients or by the Commission, it shall 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 CIF, and how the total amount spent from the account compares to the budget set by the CIF for that period, noting any rebate or carry-over if residual funds remain in the account. For the purposes of sub-paragraph (b)(i), the specific research charge shall:

- a) only be based on a research budget set by the CIF for the purpose of establishing the need for third party research in respect of investment services rendered to its clients; and
- b) not be linked to the volume and/or value of transactions executed on behalf of the clients.

(3) Every operational arrangement for the collection of the client research charge, where it is not collected separately but alongside a transaction commission, shall indicate a separately identifiable research charge and shall fully comply with the conditions set out in the first paragraph of sub-paragraph point 1(b) and in the second paragraph of sub-paragraph 1.

(4) The total amount of research charges received may not exceed the research budget.

(5) The CIF agrees with clients, in the investment management agreement or general terms of business, the research charge as budgeted by the CIF 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 CIF has a process to rebate those funds to the client or to offset it against the research budget and charge calculated for the following period.

(6) For the purposes of point (b)(ii) of sub-paragraph 1, the research budget will be managed solely by the CIF and will be based on a reasonable assessment of the need for third party research. The allocation of the research budget to purchase third party research shall be subject to appropriate controls and senior management oversight to ensure it is managed and used in the best interests of the CIF's clients. Those 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 sub-paragraph 1 (b)(iv).

The CIF will not use the research budget and research payment account to fund internal research.

(7) For the purposes of point (b)(iii) of sub-paragraph 1, the CIF may delegate the administration of the research payment account to a third party, provided that the arrangement facilitates the purchase of third party research and payments to research providers in the name of the CIF without any undue delay in accordance with the CIF's instruction.

(8) For the purposes of point (b)(iv) of sub-paragraph 1, the CIF establishes all necessary elements in a written policy and provide it to its clients. The written policy 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 CIF will take to allocate such costs fairly to the various clients' portfolios.

(9) Where the CIF provides execution services, it shall identify separate charges for these services that only reflect the cost of executing the transaction. The provision of each other benefit or service by the CIF itself to investment firms, established in the Union shall be subject to a separately identifiable charge; the supply of and charges for those benefits or services shall not be influenced or conditioned by levels of payment for execution services.

#### PART V FINAL PROVISIONS

Repeal of Directive  
DI87-01(R.AD.  
360/2017)

17. The Directive DI87-01(R.A.D 360/2017) for the Safeguarding of Client Assets, Product Governance Obligations and Inducements is hereby repealed and replaced with the present Directive.

Official Gazette,  
Third Annex (I)  
3.11.2017.

Entry into force

18. This Directive shall enter into force from the date of its publication in the Official Gazette of the Republic.