

EN

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**ORGANISATIONAL REQUIREMENTS AND IDENTIFICATION
MANAGEMENT AND DISCLOSURE OF CONFLICTS OF INTEREST BY
INVESTMENT FIRMS**

Important note: This document is a working document of the Commission services for discussion.

It does not purport to represent or pre-judge the formal proposals of the Commission

Proposed recitals

1. “Any opinion as to the present or future value or price of a financial instruments will normally qualify as recommends or suggests an investment strategy or expresses a particular investment recommendation, explicitly or implicitly, concerning on or more financial instruments or issuers thereof”.
2. “The fact that risk control and compliance functions are performed by the same person does not necessarily jeopardise the independent functioning of both functions
3. “Where successive personal transactions are effected in accordance with pre-determined instructions given by the relevant person and where that person does not later change these instructions, the obligations under Article 9 apply only to any subsequent to these instructions. The termination of instructions related to successive personal transactions shall not be deemed as a change of these instructions.
4. “The outsourcing of investment services and activities shall be considered as a material change of the conditions for the authorisation of the Investment Firm, as referred to in Article 16 par. 2 of the Directive. If outsourcing arrangements are put in place after the investment firm has obtained an authorisation according to the provisions included in Chapter I of the Directive, those arrangements will have to be notified to the competent authority in accordance with Article 16 par. 2 of the Directive”
5. “The records an investment firm shall keep shall be adapted to the type of business and the range of investment services and activities performed, provided that the record keeping obligations set in this Regulation* and in the Directive are fulfilled”
6. “The correct allocation of losses in case of omnibus accounts will depend on whether the investment firm is lending client’s instruments or it is the client himself who is lending. In the first case losses will be allocated proportionately amongst those clients that have given their consent to the lending of the instruments. In the second the loss will be allocated to the client that has lent the instruments”
7. “The circumstances which should be treated as giving rise to a conflict of interest only cover cases where there is a conflict between the interests of the firm and the duty the firm owes to the client or between the interests of one or more of its clients. This is, circumstances in which the investment firm has an incentive to place its interest or those of a relevant person or those of a person directly or indirectly linked to it by control ahead to its duty to a client under the Directive. It is not enough that the firm stands to make money or that the client stands to avoid a loss. There is a difference between profits arising from an investment firm’s normal commercial activities and profits arising from its failure to manage properly conflicts of interest”.
8. **The conflicts of interests provisions set forth in Article 20, 21 and 22 only apply where an investment service is provided by an investment firm.**
9. In complying with its obligation under the Directive, the investment firm shall pay special attention to at least the following business activities, particularly where the firm or a person directly or indirectly linked by control to the firm performs a combination of two or more of them:
 - Proprietary trading;

- Portfolio management; and
 - Corporate finance business, including underwriting and/or selling in an offering of securities and advising on mergers and acquisitions”.
10. The measures adopted by the firm to manage the conflicts of interests that might arise from the production and dissemination of material that is presented as investment research should be appropriate to protect the objectivity and independence of analysts and of the material they produce which is presented as investment research. Those measures should ensure that analysts enjoy an adequate degree of independence from the interests of the investment firm, or of its clients, where they may conflict with the interests of the persons to whom the material is disseminated
- 11.** For the purposes of Article 24, those whose responsibilities or business interests may reasonably be considered to conflict with the interests of the persons to whom the investment research is disseminated include issuers, corporate finance personnel and persons involved in proprietary trading on behalf of the firm.
- 12.** Exceptional circumstances for the purposes of Article 24 will include those circumstances where for personal reasons relating to financial hardship an analyst or other person is required to liquidate a position
- 13.** A material inducement shall not include gifts or minor hospitality below a level specified in the firm’s conflicts policy

Article 1

Subject-matter and scope

1. This Regulation lays down:
1. the organisational requirements with which Investment Firms have to comply, in accordance with article 13 of the Directive, in order to be authorised to provide Investment Services or activities.
 2. the organisational requirements relating to the arrangements which firms are required to maintain and operate in accordance with article 13(3) of the Directive; and
 3. measures relating to the identification, management and disclosure by firms of conflicts of interest, in accordance with article 18 of the Directive.
- 2.** This Regulation shall apply to credit institutions authorised under Directive 2000/12/EC, when providing one or more investment services or performing investment activities as defined by article 4 (1) (2) of the Directive and to management companies authorised under Directive 85/611/EEC when providing the service of portfolio management as defined by article 4(1) (9) of the Directive, in the same way as it applies to investment firms.

Article 2

Definitions

1. “senior management” means the person or persons who effectively direct of the business of the investment firm as referred to in Article 9 par. 1 of the Directive.
2. “*relevant person*” in relation to an investment firm, means:
 - a) a director, partner or equivalent, manager or tied agent of the firm,
 - b) a director, partner or equivalent, or manager of any tied agent of the firm,
 - c) an employee of the firm or of its tied agent, as well as any other natural person whose services are placed at the disposal and under the control of the firm or its tied agent who is involved in the provision by the firm of investment services and activities;
 - d) a natural person who is involved in the provision of services to the investment firm or to its tied agent under an outsourcing arrangement for the purpose of the provision by the firm of investment services and activities where such inclusion is appropriate in view of the nature of the arrangement and the natural person’s role;
3. “*personal transaction*” means a transaction **in a financial instrument** effected by or on behalf of a relevant person, where:
 - a) that relevant person is acting outside the scope of his professional activities, or
 - b) the transaction is carried out –
 - i) for his own account, or
 - ii) for the account of any person with whom he has a family relationship, or with whom he has close links, or
 - iii) for the account of a person whose relationship with the relevant person is such that the relevant person has a direct or indirect ~~material~~/~~significant~~**material** interest in the outcome of the transaction (other than a fee or commission for the execution of the transaction);
4. “*person with whom a relevant person has a family relationship*” means:
 - a) the spouse of the relevant person or any partner of that person considered by national law as equivalent to a spouse,
 - b) a child or stepchild of the relevant person,
 - c) any other relative of the relevant person who has shared the same household as that person for at least one year on the date of the personal transaction concerned;
5. “*outsourcing*” means an arrangement of any form between an investment firm and a service provider by which that service provider performs a process, a service or an activity behalf which would otherwise be undertaken by the investment firm itself;
6. “analyst” means a person (whether or not an employee of an investment firm) who produces the substance of investment research;
7. “associate” in relation to a person means, for the purposes of Article 24 of this [Regulation]:

- (a) a person with whom the person has a family relationship¹;
- (b) a professional adviser, trustee, or nominee of the person; or
- (c) a company or trust in which that person owns an interest directly or indirectly;

7a. Supervisory function: means the function (if any) within an investment firm with responsibility for the supervision of its senior management

8. “investment research” means a general recommendation as mentioned in section B(5) of Annex I to the Directive which:

- (a) concerns one or more financial instruments or issuers of financial instruments; and
- (b) is labelled as investment research or in similar terms, or is otherwise presented as an objective or independent explanation of the matters contained in the recommendation

9. “related financial instrument” in relation to another financial instrument means a financial instrument whose price is closely affected by price movements in that other financial instrument (including a derivative on that other financial instrument).

Organisation of the investment firm

Article 3

General organisational requirements

1. In order to comply with the obligations set out in paragraphs (2) to (8) of Article 13 of the Directive, an investment firm shall, taking into account the nature, scale and complexity of the business of that firm, and the nature and range of investment services and activities undertaken in the course of that business, ensure that:

- a) it establishes, communicates **to its relevant persons** and regularly updates ~~to its relevant persons~~ decision making procedures and an organisational structure which clearly and in documented manner specifies reporting lines and allocates functions and responsibilities
- b) its relevant persons are aware of what procedures must be followed for the proper discharge of their responsibilities;
- c) it establishes adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the investment firm;
- d) it employs personnel with the skills, knowledge and expertise necessary for the discharge of the allocated responsibilities;
- e) it establishes and maintains effective internal reporting and communication of information at all relevant levels of the investment firm;
- f) it maintains adequate and orderly records of its business and internal organisation, and

¹ This term is defined in ESC/17/2005

g) the performance of multiple functions by its relevant persons does not and is not likely to prevent those persons from discharging any particular function soundly, honestly, and professionally.

2. An investment firm shall maintain systems and procedures that are adequate to safeguard the security, integrity and confidentiality of information, taking into account the nature of the information in question.

3. An investment firm shall adopt and maintain an adequate business continuity policy which is aimed at ensuring that its essential data and functions are preserved and its investment services and activities maintained in the case of an interruption to its systems and procedures, or (where that is not possible) to enable the timely recovery of such data and functions and the timely resumption of its investment services and activities.

4. An investment firm shall adopt and put into effect accounting policies and procedures that enable it, on the request of the competent authority, to deliver in a timely manner to the competent authority financial reports which reflect a true and fair view of its financial position and which comply with all applicable accounting standards and rules.

5. The investment firm shall, monitor and, on a regular basis, evaluate the adequacy and effectiveness of the investment firm's systems, internal control mechanisms and arrangements established in accordance with paragraphs (1) to (4) above, and take appropriate measures to address any deficiencies.

Article 4

Compliance

1. In order to comply with the obligations set out in Art. 13(2) of the Directive, an investment firm shall, taking into account the nature, scale and complexity of the business of that firm, and the nature and range of investment services and activities undertaken in the course of that business, establish and maintain adequate policies and procedures aimed at ensuring effective compliance by the investment firm and its relevant persons with the firm's obligations under the Directive and its implementing measures and at enabling the competent authorities to exercise their powers effectively under the Directive. Those policies and procedures shall, in particular:

a) identify the risk of, and the risks associated with, a failure by the firm to comply with its obligations under the Directive; and

b) put in place adequate measures and procedures aiming ~~to minimise~~ **minimising** any such risk;

2. An investment firm shall maintain a permanent, and effective compliance function which functions independently and shall have the following responsibilities:

a) to monitor and-, on a regular basis, assess:

i) the adequacy and effectiveness of the measures and procedures put in place in accordance with paragraph (1)(b) in ensuring the firm's compliance with its compliance policies and procedures and its obligations under the Directive, and

ii) the adequacy and effectiveness of actions taken to address any deficiencies in the firm's compliance with those obligations; and

b) to advise and assist **the relevant** persons responsible for carrying out investment services and activities to promote compliance with the firm's obligations under the Directive.

3. In order to enable the compliance function to discharge its responsibilities properly and independently, the investment firm shall ensure that:

a) the compliance function has the necessary authority, resources, expertise and access to all relevant information

b) the compliance function reports directly to the senior management;

c) the relevant persons in charge of **the compliance function** are not involved in the performance of services or activities they monitor in the course of carrying out duties related to the compliance function; and

d) the method of determining the remuneration of the relevant persons in charge of **the compliance function** does not and is not likely to compromise their objectivity.

4. An investment firm is not required to comply with one or both of the requirements set out in paragraphs (3)(c) and (d) above if it is able to demonstrate that, in view of the nature scale and complexity of the business of that firm, and the nature and range of investment services and activities, the obligation is not proportionate, and that its compliance function continues to be effective.

Article 5

Risk control

1. In order to comply with the obligation set out in Article 13(5) to have effective policies and procedures for risk assessment, an investment firm shall:

a) establish and implement adequate risk management policies and procedures which -

i) identify the risks relating to the firm's activities, processes and systems, and

ii) set the level of risk tolerated by the investment firm;

b) adopt effective arrangements, processes and mechanisms to manage the risks referred to in paragraph (a)(i) in light of the level of risk tolerance set in accordance with paragraph (a)(ii); and

c) monitor:—

i) the adequacy and effectiveness of the investment firm's risk management policies and procedures,

ii) the level of compliance by the investment firm and its relevant persons with the arrangements, processes and mechanisms adopted in accordance with sub-paragraph (b); and

iii) the adequacy and effectiveness of measures taken to address any deficiencies in those arrangements and procedures, including failures by ~~personnel~~ **the relevant persons** of the firm to comply with such arrangements or follow such procedures;

2. Where appropriate and proportionate in view of the nature, scale and complexity of its business and the nature and range of investment services and activities, an investment firm shall establish and maintain an ~~independent~~ risk control function **that functions independently**, which

- a) implements the policy and procedures set out in paragraph 1, and
- b) in accordance with article 7, reports to, and advises senior management.

Article 6

Internal audit

In order to comply with the obligation set out in Art. 13(5) to have sound internal control mechanisms, an investment firm, where appropriate and proportionate in view of the nature, scale and complexity of its business and the nature and range of investment services and activities shall establish and maintain an internal audit function which is separated and independent from the other functions and activities of the investment firm and which shall have the following responsibilities:

- a) establishing and implementing an audit plan to examine and evaluate the adequacy and effectiveness of the investment firm's systems, internal control mechanisms and arrangements; and;
- b) issuing recommendations based on the result of work carried out in accordance with (a) and verifying compliance with those recommendations.

Article 7

Responsibility of senior management

1. An investment ~~Firm~~ **firm** must ensure that in allocating functions internally, its senior management (and ~~or~~, where appropriate, the supervisory function) is responsible for ensuring that the firm complies with its obligations under the Directive. In particular, they shall assess and periodically review the effectiveness of the policies, arrangements and procedures put in place to comply with the obligations under the Directive and take appropriate measures to address any deficiencies.

2. An investment firm shall ensure that its senior management (and, where appropriate, the supervisory function) receives:

- ~~a)~~ **a)** on a frequent basis, reports on the matters covered by Articles 4, 5 and 6 (compliance, risk control and internal audit) indicating in particular whether the appropriate measures have been taken in the event of any deficiencies.

Article 8

Complaints handling

An investment firm shall:

- a) maintain effective and transparent procedures for the reasonable and prompt handling of complaints received from retail clients or potential retail clients; and
- be) keep a record of each complaint and the measures taken for its resolution.

Article 9

Personal transactions

1. An Investment firm shall establish adequate arrangements aimed at preventing each relevant person who is subject to a conflict of interest or who has access to price sensitive information by virtue of an activity carried out by him on behalf of the firm:

- a) from entering into a personal transaction which –
 - i) that person is prohibited from entering into under directive 2003/6/EC on insider dealing and market manipulation, or
 - ii) conflicts or is likely to conflict with any obligation of the investment firm under the Directive;

b) from advising or procuring, other than in the proper course of his employment or contract for services, any other person to enter into a transaction in financial instruments which, if a personal transaction of the relevant person, would fall within sub-paragraph (a) above;

c) without prejudice to article 3 ~~ab~~) of the MAD from ~~communicating~~**disclosing**, other than in the ~~proper~~**normal** course of his employment or contract for services, any information or opinion to any other person if the relevant person knows, or reasonably ought to know, that as a result of that communication the other person will or would be likely to –

- i) enter into a transaction in financial instruments which, if a personal transaction of the relevant person, would fall within sub-paragraph (a) above, or
- ii) advise or procure another person to enter into such a transaction.

2. Those arrangements shall in particular (be designed to ensure) that:

a) each relevant person covered by paragraph 1 is aware of the restrictions on and ~~measures established~~ in connection with personal transactions established by the investment firm under paragraph (1)(a) to (c) above;

b) the firm is informed promptly of any personal transaction entered into by a relevant person, either by notification of any such transaction or by other procedures enabling the firm to identify such transactions; and

c) a record is made of the personal transaction notified to it or identified by it including any authorisation or prohibition in connection with such a transaction.

3. Paragraphs (1) and (2) do not apply:

a) in the case of personal transactions effected under a discretionary portfolio management service where there is no prior communication in connection with the

transaction between the portfolio manager and the relevant person or other person for whose account the transaction is executed. and

b) in the case of personal transactions in units in collective undertakings that comply with the conditions necessary to enjoy the rights conferred by the Directive 85/611/EEC (UCITS-Directive) or are subject to supervision on a national basis providing for an equivalent level of risk spreading in their assets, where the relevant person and any other person for whose account the transactions are effected are not involved in the management of that undertaking.

Outsourcing

Article 10

Critical and important operational functions

For the purposes of article 13(5) of the Directive an operational function is critical or important if a defect or failure in its performance would materially impair the continuing compliance of investment firm with the conditions and obligations of its authorisation or its obligations under the Directive, or its financial performance or soundness or the continuity of its investment services and activities.

Without restricting the assessment of any other function, the following functions are not to be considered as critical or important:

- a) advisory services and other services which do not form part of the investment business of the firm, including the provision of legal advice to the firm, the training of personnel, billing services and the security of the firm's premises and personnel; and
- b) the purchase of standardised services, including market information services and the provision of prices.

Article 11

~~*Quality of the internal control*~~ ***General conditions for outsourcing critical or important operational functions***

When outsourcing critical or important operational functions, or any other investment services or activities, the investment firm shall remain fully responsible for discharging all of its obligations under the Directive. In particular the outsourcing shall not –

- a) result in the delegation by senior management of its responsibility;
- b) alter the relationship and obligations of the investment firm towards its clients under the terms of the Directive;
- c) undermine ~~the assumptions on which its authorisation was based or~~ the conditions with which the investment firm has to comply in order to be and remain authorised in accordance with Article 5 of the Directive, **in particular where the outsourcing would involve the delegation of functions to the extent that the firm becomes a letter box entity;**
- d) remove or modify any other conditions subject to which the firm's authorisation was granted; or

~~ee) — involve the delegation of functions to the extent that the firm becomes a letter box entity.~~

Article 12

Conditions for outsourcing

1. An investment firm shall exercise due skill care and diligence when entering into, managing and terminating any arrangement for the outsourcing to a service provider of critical or important operational functions or of any other investment services or activities. The firm shall in particular take the necessary steps aimed at ensuring that :

- a) the service provider has the ability, capacity, and any authorisation required by law to perform the outsourced functions, services or activities reliably and professionally;
- b) the service provider carries out the outsourced services effectively, and to this end the firm shall establish methods for assessing the standard of performance of the service provider;
- c) the carrying out of the outsourced functions is properly supervised, the risks associated with the outsourcing adequately managed and that appropriate action is taken if it appears that the service provider may not be carrying out the functions effectively and in compliance with applicable laws and regulatory requirements;
- d) the investment firm retains the required expertise to effectively supervise the outsourced functions and manage the risks associated with the outsourcing;
- e) the service provider discloses to it any development that may have an impact on the carrying out of the outsourced functions effectively and in compliance with applicable laws and regulatory requirements;
- f) the arrangement for outsourcing can be terminated where necessary by the investment firm without detriment to the continuity and quality of its provision of services to clients;
- g) the service provider cooperates with the competent authorities of the investment firm in connection with the outsourced activities;
- h) the investment firm, its auditors and the competent authorities of the investment firm have effective access to data related to the outsourced activities and to the business premises of the service provider; and that the competent authorities can exercise those rights **of access**, and
- i) confidential information is protected.

1a. Where an investment firm outsources investment services to a to a service provider located in a third country, the investment firm shall ensure that:

- a) the service provider is authorised or registered [in its home country] to provide that service and is subject to prudential supervision**
- b) there are appropriate cooperation agreements between the competent authorities concerned.**

Where one of the conditions mentioned above is not satisfied, an investment firm may outsource investment services to a service provider located in a third country if the investment firm gives prior notification to its competent authority about the outsourcing arrangement and the competent authority consents to that arrangement.

2. The respective rights and obligations of the investment firm and the service provider shall be clearly allocated and set out in a written agreement. The terms of the agreement shall ~~be~~ give effect to, or be consistent with, the obligations of the investment firm under paragraph (1).

3. ~~[The investment firm shall give prior notification to the competent authority about any outsourcing arrangement of a kind mentioned in paragraph (1).]~~ **An investment firm** shall also make available on request to the competent authority all information necessary to enable the Authority to supervise the compliance of the performance of the outsourced activities with the requirements of this [Regulation] / [Directive].

Record Keeping

Article 13

Client order handling and recording requirements

~~1.~~ **1.**—An investment firm shall, in relation to every order which it receives from its clients, **and/or carries out** make a record of:

- a) the name or other designation of the client;
- b) the name or other designation of any relevant person acting on behalf of the client;
- c) identification of the financial instrument;
- d) the number or total value of financial instruments;
- e) the nature of the order;
- f) any other details, conditions and particular instructions from the client that specify how the order must be carried out;
- g) the date and exact time of the receipt or of the decision to deal of the order by the investment firm.

~~2.~~ **2.**—~~Where a retail client order is received by an investment firm by telephone, the firm shall record on a voice recording system the telephone conversation, to the extent that it relates to the order in question or to ancillary matters (such as any advice given or disclosures made in connection with the order).~~

~~3.~~ **3.**—~~Where, in view of the low frequency of orders given and/or received by an investment firm on a global basis or on any of its telephone lines, the requirement in paragraph 4 would not be proportionate, the competent authority may exempt that investment firm from that requirement on a global basis, or as applicable, in respect of that telephone line.~~

~~4. An investment firm shall retain a recording made in accordance with paragraph (24) above for as long as necessary to carry out its duties, and in any case for a period of at least [one] year.~~

Article 14

Retention of records

1. An investment firm shall retain the records required under the Directive and its implementing measures for a period of at least five years.
2. A competent authority may require an investment firm to retain any or all records which it is required to retain in accordance with paragraph (1) for more than five years if that is necessary to enable the authority to exercise its supervisory functions under the Directive up to a period justified by the nature of the instrument or transaction.
3. The records shall be retained in such a form and manner that:
 - a) the records may be readily accessed and easily reproduced on a durable medium.
 - b) the competent authority is able to reconstitute each key stage of the processing of all transactions
 - c) is designed to ensure that any corrections or other amendments as well as the contents of the records prior to any such corrections or other amendments can be easily ascertained; and
 - d) is designed to ensure that the records cannot otherwise be manipulated or altered.
4. Following the termination of the authorisation of an investment firm, records retained in accordance with paragraph (2) shall be retained for the outstanding term of the period required by that paragraph **if the Member State so decides**.
5. Each competent authority shall draw up and maintain an indicative list of the minimum records investment firms are required to keep in order to comply with paragraph 1.

Safeguarding of client assets

Article 15

Safeguarding of client assets

1. In order to comply with the requirement in Article 13(7) and (8) of the Directive to safeguard clients' rights in financial instruments and funds, an investment firm shall at least:
 - a) keep such records and accounts as are necessary to enable it at any time and without undue delay to distinguish assets held by it for one client from assets held for other clients, and from its own assets;
 - b) maintain its records and accounts in a way that ensures their correspondence to the financial instruments and funds held for clients

- c) conduct on a regular basis, reconciliations between its internal accounts and records and those of any third parties with whom those assets are held;
- d) take the necessary steps to ensure that the client funds deposited, in accordance with Article 16 below, in a central bank, a credit institution or a bank authorised in a third country are held in account or accounts identified separately from any accounts used to hold funds belonging to the investment firm;
- e) take the necessary steps to ensure that the client financial instruments deposited with a third party, in accordance with Article 17 below, are separately identifiable from the financial instruments belonging to the investment firm by virtue of differently titled accounts on the books of the third party **or other equivalent measures that achieve the same level of protection**; and.
- f) introduce adequate organizational arrangements to minimize the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.

2. If, for reasons of the applicable law, including in particular the law relating to property or insolvency, the arrangements made by an investment firm in compliance with paragraph (1) to safeguard clients' rights are not sufficient to satisfy the requirements of Article 13(7) and (8) of the Directive, the firm shall take such additional or alternative measures as it may lawfully take to allow it to comply with those obligations to the fullest extent possible.

3. If the applicable law of the jurisdiction in which the client funds or financial instruments are held prevents an investment firm from complying with paragraph (1)(d) or (e) above, that firm shall achieve an effect equivalent to that required by paragraph (1) by taking such alternative measures as it may lawfully take to enable it to comply with the obligation in Article 13(7) and (8) of the Directive to the fullest extent possible.

Article 16

Depositing client funds

- 1. An investment firm which is not a credit institution shall promptly deposit client funds into one or more accounts opened with:
 - a) a central bank;
 - b) a credit institution authorised in accordance with Directive 2000/12/EC ; or
 - c) a bank authorised in a third country.
- 2. Where an investment firm does not deposit ~~retail~~-client funds with a central bank, it shall exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution or bank where the funds are deposited and the arrangements for the holding of those funds. In particular, the investment firm shall take into account the expertise and market reputation of such institutions, as well as any legal or regulatory requirements or market practices related to holding of ~~retail~~-client funds that could adversely affect ~~retail~~-clients' rights.

Article 17

Depositing client financial instruments

1. An investment firm may deposit ~~retail~~-client financial instruments into an account or accounts opened with a third party provided that the firm 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 retail client financial instruments. In particular, the investment firm shall take into account the expertise and market reputation of the third party as well as any legal requirements or market practices related to holding of retail client financial instruments that could adversely affect retail clients' ownership rights.
2. If third parties holding retail client financial instruments and the holding and safekeeping of retail client financial instruments are subject to specific regulation and supervision in a jurisdiction, the investment firm shall deposit the retail client financial instruments with a third party subject to such regulation and supervision
3. An investment firm may not deposit ~~retail~~-financial instruments **held on behalf of retail clients** with a depository in a third country that does not regulate third parties holding client financial instruments and the holding and safekeeping of financial instruments unless the nature of financial instruments or of the investment services connected with those instruments so requires.

Article 18

Use of client financial instruments

1. An investment firm may use financial instruments held by it on behalf of a retail client for its own account ~~or for the account of another client~~ if (and only if):
 - a) the firm has provided the client, in a durable medium, clear, full and accurate information on
 - i) the obligations and responsibilities of the investment firm or of the retail client for whose account the financial instruments may be used, with respect to the use of those financial instruments (including the terms for the restitution of the financial instruments); and
 - ii) the risks involved;
 - b) the retail client has given his prior express consent to the use of the instruments on specified terms, as evidenced by his signature or an equivalent alternative mechanism, and that consent indicates that he has read and understood the information set out in subparagraph (a); and
 - c) the use of that retail client's financial instruments is restricted to the specified terms to which the retail client consented.
2. In addition to the requirements set out in paragraph (1), if a retail client financial instruments are held by a third party on an omnibus basis, the investment firm may use or enter into arrangements for lending of financial instruments held by it on behalf of a retail client for its own account or for the account of another retail client only if:

- a) each retail client whose financial instruments are held together on an omnibus basis has given his consent in accordance with paragraph (1); or
- b) the investment firm has systems and controls in place which ensure that only financial instruments belonging to retail clients who have given their prior consent in accordance with paragraph (1) are so used.

In either case, the records of the investment firm must include details of the retail client on whose instructions the use of the financial instruments have been effected and the number of financial instruments used belonging to each retail client who has given his consent, so as to enable the correct allocation of any loss.

Article 19

Reports by external auditors

An investment firm shall secure that its external auditors report at least annually to the competent authority of the home Member State of the firm on the adequacy of the firm's arrangements under Articles 15 to 18 above to ensure the firm's compliance with its obligations under Article 13(7) and (8) of the Directive.

Conflicts of Interest

Article 20

Conflicts of interest potentially detrimental to a client

~~1.~~ For the purposes of Articles 13 and 18 of the Directive, criteria for determining the types of conflict of interest that arise in the course of providing any investment and ancillary services or combination thereof whose existence may damage the interests of clients shall include (but are not restricted to) the following:

- a) the firm or a relevant person, or a person directly or indirectly linked by control to the firm is likely to make a financial gain or avoid a financial loss, at the expense of the client ~~other than the agreed commission or fee for that service;~~
- b) the investment firm, or a relevant person, or a person directly or indirectly linked by control to the firm has an interest in the outcome of a service provided to the client, or a transaction carried out on behalf of the client, which is distinct from the client's interest in that outcome;
- c) the investment firm, or a relevant person, or a person directly or indirectly linked by control to the firm has a financial or other incentive to favour the interest of another client or group of clients over the interests of the client;
- d) the investment firm, or a relevant person, or a person directly or indirectly linked by control to the firm carries on the same business as the client; and
- e) the investment firm, or a relevant person, or a person directly or indirectly linked by control to the firm receives or will receive from a person other than the client an inducement in relation to a service provided to the client, in the form of monies, goods or services, other than the standard commission or fee for that service.

~~2. The provisions under this section shall not apply to eligible counterparties as defined by article 24 of the Directive when they act on a principal to principal basis with the investment firm.~~

Article 21

Conflicts of interest policy

1. In order to satisfy the requirements mentioned in Articles 13 and 18 of the Directive, an investment firm shall draw up, maintain and implement an effective conflicts of interest policy which shall -

- a) be set out in writing; and
- b) be appropriate to –
 - i) the size and organisation of the firm; and
 - ii) the nature, scale and complexity of its business; and
- c) where the firm is a member of a group, take into account the circumstances, which the firm is or should be aware of, which may give rise to a conflict of interest arising as a result of the structure and business activities of other members of the group.

2. A conflicts of interest policy established in accordance with paragraph (1) shall, as a minimum -

- a) identify, with reference to the specific investment services and activities and ancillary services carried out by or on behalf of the investment firm, the circumstances that constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of a client.;
- b) specify procedures to be followed and measures to be adopted in order to manage conflicts that could cause damage to the interests of a client arising from a conflict of interest as specified in paragraph (a) above;

3. The procedures followed and measures adopted by an investment firm for the purposes of paragraph (2)(b) above shall ensure that relevant persons engaged in different business activities involving a conflict of interest of the kind specified in paragraph 2a above carry on those activities with an adequate degree of independence ~~of one another~~. The level of that independence shall be appropriate to the size and activities of the investment firm, and the degree of risk to the interests of a client entailed by the conflict of interest.

4. For the purpose of paragraph (2) (b) the procedures followed and measures adopted by an investment firm shall include some or all of the following **if necessary** ~~or~~ **and** appropriate to ensure the adequate degree of independence required by paragraph (3):

- a) effective procedures to prevent or control the exchange of information between relevant persons engaged in activities involving a risk of a conflict of interest where the exchange of that information may harm the interests of a client;
- b) the separate supervision of relevant persons whose principal functions involve carrying out activities on behalf of, or delivering services to, clients whose interests may

conflict, or who otherwise represent different interests (including those of the firm) that may conflict;

c) the removal of any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated, by different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities;

d) structures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out investment or ancillary services or activities; and

e) structures to prevent or control the simultaneous or sequential involvement of a relevant person in separate investment or ancillary services or activities where such involvement may impair proper conflicts management.

5. If one or more of the organisational measures and procedures mentioned in paragraph (4) is not ~~adequate or sufficient~~ **necessary or appropriate** to ensure the level of independence required by paragraph (3), an investment firm shall adopt alternative or additional measures and procedures to ~~satisfy that requirement. An investment firm may also establish alternative organisational structures provided that it can~~ ensure the level of independence required by paragraph (3).

6. ~~In case that~~ **Where, for in case of** a specific conflict of interest, **an** investment firm ~~s are~~ **is** not reasonably confident that the measures adopted under their general conflicts policy could prevent the risk to damage its clients they shall ~~alternative or additionally and~~, in accordance with article 18 (2) of the Directive, disclose the general nature or source of the conflict to its clients.

[Article 22

Record of services or activities giving rise to detrimental conflict of interest

1. The investment firm shall keep and regularly update a record of ~~any the kinds of~~ investment or ancillary activity carried out by or on behalf of the firm in which a conflict of interest of the kind specified in article 21 (2) (a) has arisen or, in the case of an ongoing activity, may arise.]

~~2. The record shall include a description of-~~

~~a) the nature of the interests which gave rise to conflict or potential conflict;~~

~~b) the categories of persons whose interests were or may be affected (either to their benefit or to their detriment);~~

~~c) the kind of activities in question including, as applicable, the type of service provided, the type of transaction carried out, and the category of financial instrument involved in a transaction; and~~

~~d) any specific measures taken to eliminate, prevent, control or otherwise manage the conflict of interest.~~

Article 23

Disclosure of conflicts of interest

1. Where Article 18(2) of the Directive requires an investment firm to disclose to a client the general nature or source of a conflict of interest, that disclosure, ~~in the case of retail clients~~: –

- a) shall be made in a durable medium; and
- b) shall include sufficient and adequate detail **as appropriate according to the nature of the client** to enable the ~~retail~~-client to take an informed decision with respect to the investment or ancillary service in the context of which the conflict of interest arises.

2. An investment firm shall provide the information mentioned in paragraph 1 to professional clients upon request.

Article 24

Additional organisational requirements where a firm produces and disseminates material presented as investment research

When an investment firm produces or arranges for the production of investment research, and subsequently disseminates it to clients or to the public under its own responsibility², that firm shall:

- (a) ensure the implementation of the measures set out in Article 21(4) of this [Regulation] as between the analysts concerned and those whose responsibilities or business interests may conflict with the interests of the persons to whom the investment research is disseminated, in order to ensure the objectivity and independence of the analysts concerned; and
- (b) have in place additional measures under Article 13(3) of the Directive to ensure that:
 - i) analysts, their associates, and employees or agents of the firm other than analysts, do not trade in a personal capacity or on behalf of the firm in financial instruments to which investment research relates, or any related financial instruments, with knowledge of the likely timing or content of that investment research, where that knowledge is not publicly available and cannot readily be inferred from what is publicly available.
 - ii) in circumstances not covered by paragraph i), analysts and their associates do not trade in a personal capacity in financial instruments to which the investment research relates, or any related financial instruments, contrary to current recommendations, except in exceptional circumstances with the written approval of a member of the firm's legal or compliance function;
 - iii) analysts and their associates do not accept material inducements from those (such as issuers) with a material interest in the subject-matter of the investment research and
 - iv) analysts, or any other persons on behalf of the investment firm, do not promise issuers favourable research coverage.

² C.f. Market Abuse Directive Implementing Directive 2003/125/EC. Article 7

Final provisions

Article 25

Final provisions

This Regulation shall enter into force on the [...] day following that of its publication in the *Official Journal of the European Union*.

This regulation shall be binding in its entirety and directly applicable in all Member States

Done at Brussels,