



Council of the European Union
General Secretariat

**Interinstitutional files:
2021/0385 (COD)**

Brussels, 26 April 2023

WK 5489/2023 INIT

LIMITE

**EF
ECOFIN
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MEETING DOCUMENT

From:	Presidency
To:	Working Party on Financial Services and the Banking Union (MiFID-MiFIR) Financial Services Attachés

Subject:	PFOF compromise proposal
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Article 39a

1. Investment firms acting on behalf of clients shall not receive any fee or commission or non-monetary benefits from any third party for executing client orders on a particular execution venue or for forwarding client orders to any third party for their execution on a particular execution venue.

The first subparagraph shall not apply to rebates or discounts on the transaction fees of execution venues unless they result in a net remuneration to the investment firm.

2. A Member State may decide that investment firms under its jurisdiction shall be exempt from the first paragraph when they provide investment services to clients domiciled or established in that Member State or in another Member State applying the same exemption.

The Member State shall notify ESMA about its decision to use the discretion as referred to in the first subparagraph. ESMA shall maintain a list of Member States using this discretion. The list shall be made available to the public and updated regularly.

For investment firms benefitting from an exemption pursuant to the first subparagraph, the conditions set out in Article 39b shall apply.

Article 39b

1. An investment firm benefitting from an exemption pursuant to Article 39a(2) shall ensure that all retail client orders regarding shares and ETFs subject to the exemption are executed on a trading venue.

2. If the order of a retail client regarding shares and ETFs that is subject to an exemption pursuant to Article 39a(2) is executed at a price that is not at or within the best bid and offer prices described in paragraph 3, the investment firm shall compensate the retail client for the difference between the price at which the order was executed and the best bid or offer price at the time of execution, unless the total consideration pursuant to Article 27(1) of Directive 2014/65 EU for the trade execution at the trading venue where the order is executed is better than at the venue of the best bid and offer price. The compensation shall be accumulated and effected as a single payment on a yearly basis.

3. The best bid and offer prices referred to in paragraph 2 shall be established by obtaining

(a) the European Best Bid and Offer (EBBO) of the CTP for shares and ETFs; and

- (b) until the CTP for shares and ETFs with the EBBO is established, the best bid and offer prices of the most relevant market in terms of liquidity pursuant to Article 4(1)(a).

Justification

The regulatory proposal aims at minimizing fragmented regimes concerning PFOF in share and ETF trading in the Union, while still offering some flexibility with respect to the different challenges for Member States concerning their financial markets.

On share and ETF trading Member States are given the option between two PFOF-regimes, where one option is to ban the practice and the other is to allow it under consumer protection requirements set out in MiFIR. The conditions set out in MiFIR for investment firms that may receive PFOF aims at being simple to apply and monitor, while guaranteeing that retail clients obtain a reasonable level of transparency and are not disadvantaged in terms of total cost consideration. The new requirement is in addition to the requirements in article 27 of Directive 2014/65/EU.

Investment firms acting in a jurisdiction that allows PFOF are allowed to offer their PFOF-services to clients in other Member States that also allow PFOF, thereby creating two regimes across the Union instead of several different ones.

Retail client orders for shares and ETFs are valuable and they should therefore be rewarded with the best available price when someone is ready to pay for receiving the order, or at least be compensated for the difference between the execution price and the best available price unless the total cost consideration is better at the PFOF venue than at the venue of the best available price. The requirement to compensate clients for the difference between execution and best price acts as an incentive for PFOF-actors to actively make sure that prices offered for financial instruments are competitive. The provision on the best price does not require that client orders must be executed at the best available price. It only requires that retail clients ultimately do not get disadvantaged in terms of total consideration. In line with general best execution requirements, an investment firm receiving PFOF is therefore not forced to compensate a retail client for not offering the best price if the total cost consideration for the client at the venue of the best bid and offer price would be worse because of a higher execution cost. For reasons of practicability any compensation should be accumulated and effected as a single payment on a yearly basis.

The proposed adjustments to Article 39a are only made to align the text to what the presidency understands was the intended scope of the article. Clarification regarding who is a PFOF-paying third party can be made in a recital, e.g. “In relation to the contract between a client and a broker, a third party is anyone other than that client or that broker. A broker acting on behalf of a client is not allowed to receive payment from anyone other than that client, whether directly or indirectly, in return for sending that clients order to a particular execution venue.”