

Consultation Paper

CP16/29\*\*\*

# Markets in Financial Instruments Directive II Implementation – Consultation Paper III



September 2016



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We are asking for comments on this Consultation Paper by 4 January 2017, except for the Chapter [16], Supervision manual (SUP), authorisation and approved persons, for which we require comments by 31 October 2016.

You can send them to us using the form on our website at:  
[www.fca.org.uk/cp16-29-response-form](http://www.fca.org.uk/cp16-29-response-form).

**Or in writing to:**

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25 The North Colonnade  
Canary Wharf  
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**Telephone:** 020 7066 9758  
**Email:** [cp16-29@fca.org.uk](mailto:cp16-29@fca.org.uk)

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We have developed the policy in this consultation paper in the context of the existing UK and EU regulatory framework. We will keep the proposals under review to assess whether any amendments will be required due to changes in the UK regulatory framework, including as a result of any negotiations following the UK's vote to leave the EU. We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

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Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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## Abbreviations used in this document

<b>AIFM</b>	Alternative Investment Fund Manager
<b>BoE</b>	Bank of England
<b>CA</b>	Competent Authority
<b>CASS</b>	Client Assets sourcebook
<b>CBA</b>	Cost benefit analysis
<b>CESR</b>	Committee of European Securities Regulators
<b>CIS</b>	Collective investment scheme
<b>COBS</b>	Conduct of Business sourcebook
<b>COLL</b>	Collective Investment Schemes sourcebook
<b>Commission</b>	European Commission
<b>CP</b>	Consultation Paper
<b>CPM</b>	Collective Portfolio Management
<b>CSA</b>	Commission Sharing Agreement
<b>CTP</b>	Consolidated Tape Provider
<b>DP</b>	Discussion Paper
<b>EEA</b>	European Economic Area
<b>ECP</b>	Eligible Counterparty
<b>EMIR</b>	European Market Infrastructure Regulation
<b>EMP</b>	Energy Market Participant

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<b>ESAs</b>	European Supervisory Authorities
<b>ESMA</b>	European Securities and Markets Authority
<b>EU</b>	European Union
<b>ETF</b>	Exchange Traded Fund
<b>FAMR</b>	Financial Advice Market Review
<b>FCA</b>	Financial Conduct Authority
<b>FEMR</b>	Fair and Effective Markets Review
<b>FG</b>	Finalised Guidance
<b>FSA</b>	Financial Services Authority (predecessor to the FCA)
<b>FSMA</b>	Financial Services and Markets Act 2000
<b>FX</b>	Foreign Exchange
<b>GEN</b>	General Provisions – FCA Handbook
<b>IDD</b>	Insurance Distribution Directive
<b>IFA</b>	Independent Financial Adviser
<b>IPM</b>	Individual Portfolio Management
<b>ITS</b>	Implementing Technical Standard
<b>KID</b>	PRIIPs Key Information Document
<b>KIID</b>	UCITS Key Investor Information Document
<b>MAR</b>	Market Conduct Sourcebook
<b>MiFID</b>	Markets in Financial Instruments Directive
<b>MiFID II</b>	Markets in Financial Instruments Directive II (includes MiFIR, where the context indicates)
<b>MiFIR</b>	Markets in Financial Instruments Regulation
<b>MTF</b>	Multilateral Trading Facility
<b>NURS</b>	Non-UCITS Retail Scheme

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<b>OMP</b>	Oil Market Participant
<b>OTC</b>	Over The Counter
<b>OTF</b>	Organised Trading Facility
<b>Parliament</b>	European Parliament
<b>PERG</b>	Perimeter Guidance
<b>PFOF</b>	Payment For Order Flow
<b>PRA</b>	Prudential Regulation Authority
<b>PROD</b>	Product Intervention and Product Governance sourcebook
<b>PRIN</b>	Principles for Businesses sourcebook
<b>PRIIPs</b>	Regulation on Packaged Retail and Insurance-based Investments
<b>RAO</b>	Regulated Activities Order
<b>RDR</b>	Retail Distribution Review
<b>RIP</b>	Retail Investment Product
<b>RM</b>	Regulated Market
<b>RPA</b>	Research Payment Account
<b>RPPD</b>	Responsibilities of Providers and Distributors for the Fair Treatment of Customers
<b>RRRs</b>	FSMA (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001
<b>RTS</b>	Regulatory Technical Standard
<b>SME</b>	Small and Medium-sized Enterprise
<b>SUP</b>	Supervision Manual
<b>SYSC</b>	Senior Management Arrangements, Systems and Controls – FCA Handbook
<b>TC</b>	Training and Competence sourcebook
<b>the Treasury</b>	HM Treasury
<b>UCITS</b>	Undertakings for collective investments in transferable securities

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# 1. Overview

## Introduction

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- 1.1** Following on from Consultation Paper (CP) 15/43 and CP16/19, we are now publishing a third consultation paper on the UK implementation of the Markets in Financial Instruments Directive (MiFID) II. MiFID II is a package of EU legislation which regulates both retail and wholesale investment business.
- 1.2** As with our previous proposals on the implementation of MiFID II we have developed the policy in this CP in the context of the existing UK and EU regulatory framework. Following the result of the UK's referendum on its membership of the EU, firms must continue to abide by their obligations under UK law, including those derived from EU law and continue with implementation plans for MiFID II and other pieces of EU financial services legislation that are due to come into effect in the UK.
- 1.3** This CP is split into two parts. Part I deals with conduct of business issues whilst Part II deals with other matters, covering a range of issues not covered in our previous two CPs.
- 1.4** Strengthening investor protection is one of the key aims of MiFID II. This is in line with our operational objective of ensuring an appropriate degree of protection for consumers. The changes to the conduct rules between MiFID and MiFID II pick up on several of the themes of recent work in the UK on retail and wholesale conduct issues, including:
- Introducing the concept of independent investment advice and requirements for firms to ensure employees providing investment advice have the necessary knowledge and competence. These are similar to the requirements of the Retail Distribution Review (RDR).
  - New product governance requirements which cover similar ground to our guidance on the responsibilities of providers and distributors for the fair treatment of customers and to points raised in recent thematic reviews.<sup>1</sup>
  - Strengthened inducements rules which are consistent with the recent work we have done on retail financial advisers and inducements.<sup>2</sup>
  - New rules on inducements and the receipt of research which will strengthen transparency and controls by investment firms over costs of third party research. This will deliver better outcomes for investors in line with FCA work and publications on the use of dealing commission since 2012, including our review in 2013-14.<sup>3</sup>

<sup>1</sup> See for example: <https://www.fca.org.uk/static/documents/thematic-reviews/tr15-02.pdf> and <http://www.fca.org.uk/static/fca/article-type/thematic%20reviews/tr16-01.pdf>.

<sup>2</sup> <http://www.fca.org.uk/news/inducements-conflicts-interest-thematic-review-key-findings>

<sup>3</sup> Including: <http://www.fsa.gov.uk/static/pubs/other/conflicts-of-interest.pdf> and <https://www.fca.org.uk/news/dp14-03-the-use-of-dealing-commission-regime>

- Enhanced rules on best execution help to address some of the issues we identified in our 2014 thematic review of firms' implementation of the existing rules.<sup>4</sup>

- 1.5** We consider that the new framework of conduct rules in MiFID II will reinforce and strengthen the retail and wholesale conduct work we have been doing in the UK. Its implementation should help to ensure that markets work well for consumers.
- 1.6** The Financial Advice Market Review<sup>5</sup> (FAMR) recommended that, in implementing MiFID II, we were mindful of proposals to aid firms in delivering streamlined advice. We are confident that steps both we and the Treasury are taking to transpose and implement MiFID II are consistent with the FAMR recommendation.
- 1.7** The Treasury has published a consultation paper<sup>6</sup> to amend the wording in Article 53 of the Regulated Activities Order to reflect the definition of a personal recommendation as set out in the Markets in Financial Instruments Directive (MiFID), in line with the recommendation in FAMR. Depending on the outcome of this consultation, we may need to consider the impact of any changes on our proposals on inducements.

#### ***Insurance-based investments and pensions, and structured deposits***

- 1.8** The proposals on conduct in this CP follow up on the issues we raised in Discussion Paper (DP) 15/3.<sup>7</sup> There were two general issues covered in that DP. Firstly, whether we would apply the MiFID II conduct rules to insurance-based investment business and pensions. Secondly, whether we would incorporate the MiFID II rules which apply to the activities of advising on or selling structured deposits into our Conduct of Business sourcebook (COBS).
- 1.9** There were mixed responses to DP15/3 on the question of applying MiFID II conduct rules to insurance-based investment business and pensions. Some respondents felt it was important to have a single set of rules applying to substitutable types of business. However, some also felt it would be premature to do so before more details were known of the implementing measures under the Insurance Distribution Directive (IDD). Others raised concerns about the specific application of certain MiFID II rules to insurance-based investment business and pensions, such as the appropriateness test.
- 1.10** The IDD is due to apply in the first quarter of 2018 shortly after MiFID II applies. Its implementing measures are still to be finalised, so we have not proposed applying MiFID II conduct rules to insurance-based investment business and pensions in this CP. However, we think there remains a good case for having a significant degree of consistency of conduct rules across investment business. While our ability to deliver such consistency will depend on the final shape of the final IDD implementing measures, we will return to this subject when we consult on implementing the IDD in 2017.
- 1.11** On structured deposits respondents to DP15/3 were mainly in favour of putting MiFID II rules dealing with structured deposits into COBS. This is what the proposals in this CP do. We have not proposed including the activities of advising on, and selling, structured deposits within the scope of designated investment business. Rather, we propose applying individual conduct rules to such activities as required by Article 1(4) of MiFID II. We also believe that Article 3 firms (this term is explained in paragraph 1.13) can advise on and sell structured deposits, and, in doing so should be subjected to the relevant analogous requirements. As such, the issues that arise out of this are dealt with in the relevant individual chapters in Part I of this CP.

<sup>4</sup> <https://www.fca.org.uk/static/documents/thematic-reviews/tr14-13.pdf>.

<sup>5</sup> <https://www.fca.org.uk/static/fca/documents/famr-final-report.pdf>

<sup>6</sup> <https://www.gov.uk/government/consultations/amending-the-definition-of-financial-advice-consultation>

<sup>7</sup> <https://www.fca.org.uk/static/documents/discussion-papers/dp15-03.pdf>

**Other non-MiFID business**

- 1.12** Rules in COBS cover other non-MiFID business as well as insurance-based investment business and pensions. This includes business conducted by firms exempt under Article 3, and other investment business covered by various specialist regimes in COBS 18 including firms when carrying out collective portfolio management activity.
- 1.13** In CP16/19 – see paragraphs 1.17 to 1.23 – we discussed our approach to implementing MiFID II for firms exempt under Article 3. These are firms providing investment advice and/or receiving and transmitting client orders in relation to a restricted range of financial instruments, which do not hold client assets or money and do not do business outside of the UK. MiFID II requires that such firms are subjected to ‘at least analogous’ requirements to each of the individual organisational and conduct requirements listed in Article 3(2)(a) to (c) of MiFID II and their corresponding implementing measures.
- 1.14** In this CP we propose applying the same conduct rules to Article 3 firms as to MiFID investment firms where the conduct rules are on the list of analogous requirements. We consider that these requirements, as well as being analogous, have their own benefits in helping to achieve high standards of conduct. Where conduct rules are not on the list of at least analogous requirements we make case-by-case decisions on whether to impose new requirements coming from MiFID II on Article 3 firms. The issues this approach creates are dealt with in each of the relevant chapters in Part 1 of this CP. In Part II of the CP we also make proposals about tapping for Article 3 firms, a systems and controls requirement that is on the list of analogous requirements that we did not cover in CP16/19.
- 1.15** We make some proposals in this CP for non-MiFID business that is not insurance-based investment or pensions business or investment business undertaken by Article 3 firms. We indicate in relevant chapters in Part I where we seek to apply MiFID II standards to this business, and where we do not.
- 1.16** A significant number of firms conduct MiFID and non-MiFID designated investment business. Our proposal not to apply MiFID II conduct standards to all designated investment business means that different sets of rules would apply to different aspects of a firm’s business. We recognise that firms may find it more practical to take a single approach to compliance for closely connected lines of business notwithstanding the differing regulatory standards. Therefore, if we decide, post-consultation, to adopt our proposal, firms should be able, as far as is feasible, to choose to apply a single set of standards based on the higher standards. We will consider further whether we need to make specific proposals to support this.

**Third country firms**

- 1.17** In CP16/19 – see paragraphs 1.13 to 1.16 - we discussed our approach to implementing MiFID II for branches of non-European Economic Area firms (third-country firms). We said we would apply the same conduct rules to these firms as we do to MiFID investment firms to ensure they are treated no more favourably than branches of EEA firms. The conduct proposals in this CP for MiFID investment firms therefore also apply to branches of third-country firms.

**EU legislation and the Handbook**

- 1.18** A significant part of the conduct rules in MiFID II are regulations which are directly applicable. MiFID’s implementing directive (Commission Directive 2006/73/EC) has been replaced by a delegated directive<sup>8</sup> and a delegated regulation,<sup>9</sup> with most of the conduct-related implementing provisions under MiFID II being found in the delegated regulation. In light of the links between

<sup>8</sup> [http://ec.europa.eu/finance/securities/docs/isd/mifid/160407-delegated-directive\\_en.pdf](http://ec.europa.eu/finance/securities/docs/isd/mifid/160407-delegated-directive_en.pdf)

<sup>9</sup> [http://ec.europa.eu/finance/securities/docs/isd/mifid/160425-delegated-regulation\\_en.pdf](http://ec.europa.eu/finance/securities/docs/isd/mifid/160425-delegated-regulation_en.pdf)

the MiFID II provisions and the delegated regulation, and the use that a wide range of firms make of COBS, we propose to copy out various conduct provisions in the delegated regulation into the Handbook. Some of the provisions in the delegated regulation will apply as rules to firms conducting non-MiFID business (including Article 3 firms). We explain references to the delegated regulation in COBS in a proposed new section in the application chapter of COBS 1.2. We also propose to use this section to 'translate' some words and phrases used in the copied out text to defined Handbook terms for the benefit of firms to whom such provisions will apply as rules.

- 1.19** In drafting the Handbook we have also in some cases decided that the clearest approach is to have separate chapters for MiFID and non-MiFID business. This is where we have judged that to try and combine the provisions in a single chapter would make the application provisions too complex.
- 1.20** In our previous two CPs we provided a Handbook Guide on how the requirements in EU legislation are being carried across to UK legislation and the Handbook. We are not doing this in this CP. We will consider whether to do this in due course and will discuss this with firms and trade associations during the consultation period.
- 1.21** Under Article 4 of the MiFID implementing directive Member States were able to impose additional requirements to those under MiFID in certain circumstances. The UK has made a number of 'Article 4' notifications<sup>10</sup> to do this. MiFID II allows certain additional requirements which have been notified to the Commission under MiFID to be retained and allows, in more limited circumstances than under MiFID, Member States to notify new additional requirements.
- 1.22** Some of the existing conduct notifications have been overtaken by the revised provisions in MiFID II, such as that relating to the use of dealing commission. Based on the proposals in this CP others, such as some of those relating to the RDR, remain relevant. We will be considering whether we need to make new notifications under MiFID II. It is possible that this may be necessary if, for example, we end up going ahead with our proposals on inducements.

#### ***Wider UK implementation of MiFID II***

- 1.23** Implementation of MiFID II also involves changes to UK legislation and changes to the rules of the Prudential Regulation Authority (PRA). The proposals in this CP are based on the draft statutory instruments that the Treasury published in its March 2015 CP - these were produced for the purposes of consultation and both the drafting and policy may be subject to change. The PRA will publish in due course a Policy Statement which follows on from the policy proposals in its CP9/16, which covered passporting and algorithmic trading.

#### ***Finalising transposition***

- 1.24** As part of our transposition work we continue to analyse all of the consequential changes which need to be made within the Handbook, including to the specialist regimes in COBS. We think this work will lead to us issuing a further consultation later this year. We will publish a policy statement covering all aspects of our implementation of MiFID II in the first half of 2017.

**Q1: Do you have comments on the general issues raised in this overview, such as: the application of MiFID conduct rules to non-MiFID business; our approach to applying COBS rules to firms selling and advising on structured deposits; and our approach to the structure of COBS?**

<sup>10</sup> [http://ec.europa.eu/finance/securities/isd/mifid\\_implementation/index\\_en.htm](http://ec.europa.eu/finance/securities/isd/mifid_implementation/index_en.htm).

## Summary of proposals

**1.25** In this CP we seek views on the proposed changes to the Handbook in the areas below, several of which reflect feedback we received to DP15/3. We split the content into two parts, conduct of business and other matters:

### *Part I – Conduct of Business*

- **Inducements, including adviser charging** – Our general approach is to implement the MiFID II provisions for MiFID business and the MiFID-scope business of Article 3 firms, while keeping the existing rules in place for non-MiFID business until we implement the IDD. For retail clients, we propose applying the MiFID II inducements standards to both independent and restricted advice, continuing to ban the rebating of inducements, and extending this to portfolio management. For personal recommendations on retail investment products (RIPs) to retail clients in the UK, we keep the existing RDR standard set out in the adviser charging rules, and clarify that it applies to the wider business of providing advice.
- **Inducements and research** – Given the link in MiFID II to the inducements rules, we propose replacing our existing use of dealing commission rules in COBS 11.6 with a new section in COBS 2 to transpose the MiFID II rules. We also propose that the MiFID II rules should apply to firms carrying out collective portfolio management, which includes UCITS management companies and Alternative Investment Fund Managers (AIFMs), but who are not subject to MiFID II.
- **Client categorisation** – We propose criteria for the opting up of local authorities (and local authority pension schemes) from retail client status to elective professional client status.
- **Disclosure requirements** – We propose changes to implement the wide variety of disclosure requirements in MiFID II. These include information about the firm and the products it sells, disclosure of costs and charges and the provision of periodic reports to clients.
- **Independence** – We propose to apply the MiFID II independence standard for personal recommendations to recommendations relating to MiFID financial instruments, structured deposits and (in relation to retail clients in the UK) non-MiFID RIPs.
- **Suitability** – We propose to update the current suitability rules in COBS 9 with the changes required by MiFID II. The changes will apply to MiFID business and to Article 3 firms carrying on MiFID business. The current COBS rules will continue to apply to non-MiFID business pending consultation on implementation of the IDD.
- **Appropriateness** – MiFID II extends the products classified as ‘complex’, meaning the appropriateness test will apply more widely. We are copying out the changes in MiFID II about the way in which the test operates, including more detailed criteria for determining whether a product is ‘non-complex’. We propose applying the revised rules to MiFID business only.
- **Dealing and managing** – We propose changes to our existing rules to implement the new MiFID II standards across best execution, client order handling, personal transactions and requirements for investment firms underwriting and placing. We also propose to apply the MiFID II enhancements to the best execution rules to firms carrying out collective portfolio management who are not subject to MiFID II, with some selected exceptions.
- **Investment research** – We propose to transpose the MiFID II rules into a single chapter in COBS.

- **Other conduct issues** – The requirement for a written basic agreement will now also apply to professional clients for MiFID business. We give more specific detail of the content of these agreements. We also propose some further changes in the COBS specialist regimes chapter for firms carrying out collective portfolio management activity, to make it clearer.

#### **Part II – Other matters**

- **Product Governance** – We propose to implement product governance provisions in MiFID II as rules for firms engaged in MiFID business and as guidance for non-MiFID firms which manufacture or distribute MiFID products.
- **Knowledge & competence requirements** – We will comply with the European Securities and Markets Authority (ESMA) guidelines on knowledge and competence and propose to make small amendments to our Training and Competence (TC) sourcebook and Senior Management Arrangements, Systems and Controls (SYSC) to reflect this.
- **Recording of telephone conversations and electronic communications (taping)** – We propose to update our current taping rules with the changes required by MiFID II. We are proposing that discretionary investment managers be fully subject to the requirement to tape, and the taping requirement applies to corporate finance business. Also our view is that taping should be extended to Article 3 firms but we are open to considering other proposals to address consumer protection concerns in this area.
- **Supervision, authorisation and approved persons** – We propose introduction of a new Form A to give us information on a firm's organisational structure and management body. Unlike our other proposals, the consultation on this closes at the end of October so that we can have the forms in place when we open the gateway for firms seeking to be authorised in early 2017.
- **Perimeter guidance** – We propose new guidance on scope changes in MiFID II. These include foreign exchange derivatives, emission allowances, commodity derivatives and exemptions for professional firms and commercial firms trading commodity derivatives.
- **Consequential changes to the Handbook** – Based on our proposals in CP16/19 on SYSC and CASS (our Client Assets sourcebook), we propose some consequential amendments to the Handbook. We also propose updates to some references in our prudential rules.

#### **Equality and diversity considerations**

- 1.26** We have considered the equality and diversity issues that may arise from the proposals in this consultation.
- 1.27** Overall, we do not consider that the proposals in this consultation paper adversely affect any of the groups with protected characteristics ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment. In fact, the management body provisions of MiFID II require firms to have targets to increase the representation of women on management bodies, and to have a policy to ensure the management body is adequately diverse.
- 1.28** We will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them when publishing the final rules. In the interim, we welcome any input to this consultation on these issues.

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### Who does this consultation affect?

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**1.29** At the start of each chapter we state which firms it is most likely to be relevant to. This consultation affects a wide range of firms that we authorise and recognise (as well as unregulated entities trading commodity derivatives), particularly:

- banks
- investment firms
- interdealer brokers
- stockbrokers
- investment advisers
- corporate finance firms and venture capital firms
- investment managers, including individual and collective portfolio managers
- financial advisers
- local authorities

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### Is this of interest to consumers?

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**1.30** Each chapter notes the implications for consumers. Consumers have a clear interest in financial markets that operate fairly and transparently, which is the rationale for the proposals in this Consultation. Some of the subjects covered, including the conduct of business rules will be of most concern to consumers. However, the proposals should not adversely affect any of the groups with protected characteristics. The conduct proposals aim to improve firms' existing efforts to ensure they act in their clients' best interests and so may help ensure that firms consider the needs of vulnerable consumers when these consumers seek to purchase investment services.

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### Next steps

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#### What do you need to do next?

**1.31** We want to know what you think of our proposals. Please send us comments by 4 January 2017, except for the proposals in Chapter 16, Supervision (SUP), authorisation and approved persons, where responses should reach us by 31 October 2016.

#### How?

**1.32** Use the online response form on our website or write to us at the address on page 3.

#### What will we do?

**1.33** We will consider your feedback and publish our rules in a Policy Statement in the first half of 2017. We will also publish a further CP, as explained above, on the other Handbook changes required to implement MiFID II.

# Part I – Conduct of Business



## 2. Inducements, including adviser charging

### Who should read this chapter

Firms conducting MiFID or equivalent third country business, and firms conducting non-MiFID business (including Article 3 firms)

Consumers and consumer organisations

### Introduction

- 2.1** MiFID II enhances the existing MiFID inducements standards.
- For both independent advisers and portfolio managers (discretionary investment managers), it bans the receipt and retention of all monetary and non-monetary benefits from third parties, other than ‘minor non-monetary benefits’, when dealing with retail and professional clients.
  - For all other MiFID investment activities, the existing MiFID implementing directive provisions are now included in MiFID II. These are substantially similar to the provisions in the MiFID implementing directive on which our existing core inducements rules in COBS 2.3 are based.
- 2.2** MiFID II also sets out new implementing provisions. Generally, these focus on:
- acceptable minor non-monetary benefits relating to independent advice and portfolio management
  - what benefits can be considered under the MiFID II inducement rule for other investment services to be designed to enhance the quality of the service to clients, and
  - record-keeping and disclosure requirements for inducements
- 2.3** The provisions in the MiFID II delegated directive also set out a bespoke regime to allow investment firms to receive research without this constituting an inducement. This is also relevant to our existing ‘use of dealing commission’ rules in COBS 11.6. Our approach to inducements in relation to research is discussed separately in Chapter 3. This includes setting out our proposals to apply the new MiFID II inducements and research provisions to non-MiFID collective portfolio management activity.

**2.4** This chapter explains our proposals to amend:

- COBS 2.3 to implement MiFID II's inducement requirements, including the new commission bans for independent advice and portfolio management
- COBS 6.1A and 6.1B

#### **Existing provisions**

**2.5** Our existing core inducements rules in COBS 2.3 apply to designated investment business (ie to both MiFID and non-MiFID business, including to business relating to insurance-based investments), and also to ancillary services provided in relation to MiFID business.

**2.6** Generally, the payment or receipt of a fee, commission or non-monetary benefit (inducements) to or from a third party is not allowed unless it:

- is designed to enhance the quality of the service to the client
- does not impair the firm's compliance with its duty to act honestly, fairly and professionally in accordance with the best interests of its client, and
- is clearly disclosed to the client

**2.7** The circumstances in which inducements can be paid or received in relation to most types of non-MiFID business are less prescriptive.

**2.8** Payments or benefits which are necessary for the provision of investment services and which do not impair the firm's duty to act in the best interest of the client are allowed. These include custody costs, settlement and exchange fees, regulatory levies or legal fees – which we refer to as 'proper fees'.

**2.9** In addition to the disclosure obligation, the current rules also set out firms' record-keeping obligations in relation to inducements.

**2.10** In December 2012, as part of the RDR, we introduced new adviser charging rules in COBS 6 for the retail investment advice market. Building on the inducements regime, these rules were designed to remove the potential for adviser remuneration to distort the advice that consumers receive. The rules require that advisers providing advice to retail clients in the UK on RIPs are remunerated by adviser charges agreed with, and paid by, clients (rather than through commissions or other types of monetary or non-monetary benefit).

#### **Supervisory work**

**2.11** The MiFID II inducements rules are also consistent with our extensive recent work on inducements undertaken in relation to retail financial advisers. In January 2014, we published our Finalised Guidance 'Supervising retail investment advice: inducements and conflicts of interest' (FG14/1)<sup>11</sup> which sought to clarify our expectations where behaviours could result in firms breaching Principle 8 (Conflicts of interest) and the COBS inducements rules.

<sup>11</sup> 'FG14/1 – Supervising retail investment advice: inducements and conflicts of interest' (January 2014): <https://www.fca.org.uk/your-fca/documents/finalised-guidance/fg14-01> .

- 2.12** In 2015, we undertook follow-up supervisory thematic work. The scope of this work was wider than the previous work on distribution agreements. We found widespread provision of non-monetary benefits which appeared to be in breach of our rules and were, in many cases, excessive. As a result of this work, in April 2016 we published our key findings and expectations.<sup>12</sup>
- 2.13** We have also undertaken work over recent years examining the practice of ‘payment for order flow’ (PFOF). As a result of this work, we published Finalised Guidance (FG12/13) in 2012.
- 2.14** Our follow-up supervisory work on PFOF in 2014 found that some poor practices were continuing in this area, which we reported on in our Thematic Review TR14/13. We consider that the core MiFID II inducements rule is consistent with, and indeed reinforces, our view on the unacceptability of PFOF arrangements.

### Proposals

- 2.15** In DP15/3 we discussed:
- applying a consistent inducements regime to business involving both MiFID financial instruments and insurance-based investments and pensions
  - applying the MiFID II inducement standard for independent advice also to non-independent advice, given that our adviser charging and inducements rules currently apply to all adviser firms
  - prohibiting investment advisers from receiving monetary benefits and the rebating of these to retail clients – in line with our existing RDR rules (COBS 6.1A.4R(2))
  - prohibiting discretionary investment managers from receiving monetary benefits from third parties and rebating them to retail clients
- 2.16** In broad terms, the proposals we are making in this paper involve:
- separating our core inducement rules for MiFID, equivalent third country and Article 3 firm (optional exemption) business (into a new COBS 2.3A) from other non-MiFID designated investment business (in COBS 2.3) in light of our current position on the IDD implementing measures discussed in Chapter 1
  - retaining our existing domestic adviser charging rules in COBS 6.1A and 6.1B, and transposing MiFID II’s new inducement bans into the new COBS 2.3A
  - for firms providing independent investment advice and portfolio management services to professional clients, transposing (but not extending) MiFID II’s inducements ban
  - for firms providing investment advice and portfolio management services to retail clients, extending MiFID II’s inducement ban in three ways:
    - firstly, so that it extends to restricted advice as well as independent advice
    - secondly, to prohibit the acceptance of commission and benefits rather than their acceptance and retention (ie to ban rebating of inducements to retail clients), and

<sup>12</sup> ‘Inducements and conflicts of interest thematic review: key findings’ (April 2016):  
<https://www.fca.org.uk/news/inducements-conflicts-interest-thematic-review-key-findings> .

- thirdly, to amend the adviser charging rules by applying the ban to the business of providing advice rather than only to inducements provided in relation to the provision of a particular personal recommendation to a client<sup>13</sup>

- subjecting Article 3 firms to the same requirements in relation to inducements as MiFID firms

**2.17** These proposals are discussed further below.

### **General inducement rule**

**2.18** Although our preference is to retain the wider scope of application of the core inducement rules to all designated investment business, we are mindful that we will also need to take account of relevant forthcoming implementing measures, including on inducements, under the IDD. At this stage, therefore, our general approach is to implement, in a new COBS section (COBS 2.3A), the MiFID II inducement provisions for MiFID, equivalent third country and Article 3 firm (optional exemption) business only, and to keep in place the existing COBS 2.3 rules for all other business until such time as we consult on IDD implementation.

**2.19** However, we propose clarifying the adviser charging rules by prohibiting acceptance of non-monetary benefits – but not minor non-monetary benefits – in relation to all RIPs, including those RIPs that are not MiFID products, and to clarify the application of these rules to the business of providing advice, rather than just in relation to particular personal recommendations. These changes are intended to prevent firms seeking to circumvent the RDR rules by claiming that benefits such as excessive hospitality are not linked to personal recommendations.

**2.20** For the new COBS section on the MiFID II inducement provisions for MiFID, equivalent third country and Article 3 firm (optional exemption) business, we propose transposing:

- the list of acceptable minor non-monetary benefits set out in Article 12(3)(a)-(d) in the MiFID II delegated directive, and the associated second paragraph thereof – *‘acceptable minor non-monetary benefits shall be reasonable and proportionate and of such a scale that they are unlikely to influence the investment firm’s behaviour in any way that is detrimental to the interests of the relevant client’* (this will also be reflected in the adviser charging rules)
- the various information and disclosure requirements that firms are required to provide to their clients
- the record-keeping requirements

**2.21** In respect of non-monetary benefits which are capable of enhancing the quality of the service to the client - for the purpose of the rules on independent/restricted advice for retail clients, independent advice for professional clients, and portfolio management - we propose including provisions on the quality enhancement conditions relating to fees, commissions and non-monetary benefits which are designed to enhance the quality of the relevant service to the client in the context of the general inducement rule in Article 24(9) of MiFID II and Article 11(2) and 11(3) of the MiFID II delegated directive.

**2.22** We propose including a reference to FG12/13 on PFOF. This will ensure that our expectations that have already been set out, including in TR14/13, are embedded in the Handbook.

**2.23** We will delete the existing guidance that provides a link to COBS 11.6 on the use of dealing commission rules which reminded investment managers of the link with the inducements rules.

<sup>13</sup> See also paragraph 1.7 in Chapter 1.

We will replace it with guidance to provide a link to our transposition of the MiFID II inducements and research provisions, which we propose copying out into a separate inducements section in COBS 2.3B. This will replace our dealing commission rules. We discuss this further in the next Chapter. The research and inducements requirements are relevant to COBS 2.3A, as they provide an alternative approach for investment firms to receive third party research without it constituting an inducement, as long as the provisions are met.

### ***Advice and portfolio management***

- 2.24** With the exception of minor non-monetary benefits, Article 24(7) and Article 24(8) of MiFID II restrict, respectively, firms providing either investment advice on an independent basis and/or portfolio management from accepting and retaining third party inducements. As noted earlier, we propose also applying the ban to restricted advice and banning rebating for firms providing such services to retail clients.
- 2.25** The responses to DP15/3 expressed widespread support for a consistent inducements standard across all advisers.
- 2.26** We propose transposing MiFID II's inducement ban for independent advice in a new COBS 2.3A. In light of the responses to DP15/3, we also propose applying the MiFID II commission ban to restricted advice provided to retail clients, in line with our existing national standards (RDR). Under our proposals, this would apply in relation to MiFID, equivalent third country and Article 3 firm (optional exemption) business – as well as advising on RIPs.
- Q2: Do you agree with our proposal to apply the MiFID II inducement rules for independent advice to all advice provided to retail clients? If not, please give reasons why, including evidence as to why, in your view, the costs of such an approach would outweigh benefits.**
- 2.27** In transposing MiFID II's ban on the payment and receipt of commissions and other benefits by advisers, we also propose reflecting our existing RDR ban on advisers receiving inducements in relation to advice on RIPs even if they intend to rebate them to retail clients. We propose extending this to both independent and restricted advice to retail clients (but not professional clients) for all MiFID products, structured deposits, and for Article 3 firms.
- 2.28** MiFID II applies the inducement ban to independent advice provided to professional clients, and we intend to transpose this new MiFID requirement. However, we do not intend to extend the inducement ban to restricted advice provided to professional clients. And we do not propose applying the rebating ban to independent advice provided to professional clients. Such changes would go beyond both what we currently require and we have not observed a market failure that would justify an extension of our rules to restricted advice for professional clients. In effect, firms will be able to accept, but not retain, payments in relation to independent advice and to receive commissions for restricted advice.
- 2.29** There was also broad support for prohibiting discretionary investment managers from rebating inducements to retail clients. We have since considered whether to extend this rebating ban to portfolio managers when dealing with professional clients, as it may be more practical for firms and will help to prevent bias in investment decisions. However, we have decided to seek views first before finalising our policy in this regard.

**Q3: Do you agree with our proposal to ban firms providing advice or portfolio management services to retail clients from receiving and rebating monetary benefits to such clients? If not, please give reasons why, including evidence as to why, in your view, the costs of such an approach would outweigh benefits.**

**Q4: Do you consider that the ban on receiving and rebating monetary benefits to clients should also apply to professional clients? If so, please explain why and provide cost-benefit data. If not, please give reasons why.**

### **Article 3 firms**

**2.30** We are of the view that the policy basis for extending MiFID II's inducement ban in relation to advice to retail clients applies equally to Article 3 firms providing advice. MiFID II provides that these firms must be subject to requirements which are 'at least analogous' to those in MiFID II Article 24(7) (and the relevant implementing measures in the MiFID II delegated directive), which bans receipt and retention of all monetary and non-monetary benefits, other than minor non-monetary benefits, for independent advice. In line with our approach to MiFID firms, we propose extending this ban to restricted advice provided to retail clients. We also propose that Article 3 firms should be subject to the restriction on rebating inducements to retail clients.

**2.31** Further, we consider that it would be sensible for the core inducement rule set out in MiFID II Article 24(9), on which the existing COBS 2.3 is based, to apply also to these firms, as these requirements are important investor protection measures. Therefore, we propose that the new rules in COBS 2.3A will apply to Article 3 firms.

**Q5: Do you agree that we should apply MiFID II's requirements in relation to inducements to Article 3 firms? If not, please explain why, and also provide cost-benefit data to support your explanation.**

### **RDR adviser charging rules**

**2.32** Notwithstanding the introduction of the new inducement bans in Articles 24(7) and 24(8) of MiFID II, we propose retaining our existing adviser charging rules (introduced as part of the RDR) in COBS 6.1A and 6.1B.

**2.33** The RDR adviser charging rules in COBS 6.1A and 6.1B:

- Ban firms from accepting or paying commission for all personal recommendations (provided on either an independent or restricted basis) on RIPs. Some of these are MiFID financial instruments, and some are not, eg life policies and personal pensions.
- Only apply to advice given to retail clients in the UK (and not professional clients).
- Ban firms from accepting commission even if they intend to rebate it to clients.

**2.34** COBS 6.1A.4R currently requires advisory firms, whether providing independent or restricted advice to retail clients in relation to RIPs, to be paid only through adviser charges agreed by the client in relation to the provision of a personal recommendation.

**2.35** The RDR adviser charging rules will continue to have a different scope from the MiFID requirements, and RIPs which fall within MiFID will be subject to both MiFID II and RDR requirements.

**2.36** However, we propose amending the RDR adviser charging rules to

- clarify that they apply in relation to the wider business of providing investment advice
- confirm that the only types of non-monetary benefit which may be paid and accepted in relation to advice to retail clients on RIPs (whether MiFID-scope or not) are minor non-monetary benefits

**2.37** This will have the effect, in line with the original objectives of the RDR and our subsequent guidance, of establishing a regulatory standard that prevents providers from providing benefits – apart from permitted MiFID II ‘minor non-monetary benefits’ – to advisory firms that have the potential to distort the advice that retail clients receive, and therefore distort client outcomes. The rule changes to COBS 6.1A and COBS 6.1B that give effect to this change are limited to RIPs. We would welcome views on whether we should also apply the provisions on minor non-monetary benefits to wider advice to retail clients on MiFID products generally, through corresponding changes in the new COBS 2.3A for MiFID business.

**2.38** Thematic work following the introduction of the RDR has indicated that firms continue to use various types of payment as a means of securing distribution which we regard as undermining the spirit of the RDR. While recent follow-up work has demonstrated improvements in this area, we remain concerned about the potential for advice to be biased as a result of payments made by distributors.

**2.39** In light of this, we propose clarifying in our transposition of MiFID II’s inducement ban, and by amending the existing adviser charging rules, that the inducement ban relating to both independent and restricted advice should be understood as applying the wider business of providing advice rather than only to payments made in relation to the provision of a particular personal recommendation.

**Q6: Do you agree with our proposal to extend the MiFID II limitation on non-monetary benefits to the wider business of providing advice in respect of RIPs? If not, please give reasons why.**

**Q7: Do you think we should extend the MiFID limitation on non-monetary benefits to the wider business of providing advice for all MiFID products, and not just RIPs? If so, please explain why and provide cost benefit data.**

### ***Structured deposits***

**2.40** The current inducements rules apply to ‘designated investment business’, which does not include activities relating to structured deposits. However, MiFID II includes structured deposits in its scope, so these products will be subject to the MiFID II requirements under the new COBS 2.3A.

**2.41** In DP15/3 we asked whether structured deposits should be added to the definition of ‘retail investment product’ for the purpose of independence. The majority of respondents supported this suggestion. However, we do not propose to make these products subject to the full



adviser charging rules as this would apply other RDR requirements. For this reason, the rules on independence will refer to financial instruments, retail investment products and structured deposits, rather than amending the definition of ‘retail investment product’ to include structured deposits (see Chapter 6).

- 2.42** Given that we will not amend the Glossary definition of ‘retail investment product’, the adviser charging rules, including the disclosure requirements, will not apply to structured deposits. However, advice on, and sales of, these products will be subject to the inducement provisions in Articles 24(7), (8) and (9) of MiFID II. We propose to apply these requirements to business involving advice on structured deposits in the same way as to MiFID financial instruments.

**Q8: Do you agree with our proposal not to subject advice on structured deposits to our existing RDR adviser charging rules and, instead, to apply only the MiFID II inducement requirements to such business? If not, please give reasons why.**

#### ***Continued relevance of Finalised Guidance***

- 2.43** Given the concerns we found in our supervisory work about hospitality and other benefits being provided which do not enhance the quality of service to clients, we also propose clarifying our expectations by including a reference to FG14/1 in the draft rules.

#### ***Implications for firms***

##### ***Independent investment advice***

- 2.44** Under our proposals, we will apply the MiFID II rules (extended to ban rebating) to firms offering either independent or restricted advice to retail clients. We propose amending the adviser charging rules to apply the MiFID II provisions relating to minor non-monetary benefits to business within the scope of these rules. We also plan to clarify that the commission ban in COBS 6.1A/6.1B should be understood as applying to the firm’s wider business of providing advice, so that an activity does not need to relate directly to the provision of a personal recommendation for these provisions to apply. We do not expect there to be significant impact on firms that comply with our current rules and guidance on this.

- 2.45** The MiFID II rules apply equally to retail and to professional clients. For professional clients, we propose transposing MiFID II into our Handbook. This is likely to have some impact on firms that currently provide independent advice to professional clients, thereby restricting the types of payments they are able to accept from third parties in relation to independent advice.

##### ***Portfolio management***

- 2.46** We propose that firms that manage portfolios can still accept fees, commissions or monetary benefits in relation to services provided to professional clients, provided they are rebated to the client; but that they should not be able to accept and rebate benefits in relation to retail clients. Non-monetary benefits may not be accepted, unless they are minor or constitute research that is received in line with Article 13 of MiFID II delegated directive. We discuss this in the next Chapter.

##### ***General inducement rule***

- 2.47** MiFID II provides more detail about benefits that are considered to enhance the quality of service provided to clients and augments the disclosure requirements on third party payments. Otherwise, the MiFID II inducements regime is broadly consistent with the existing requirements under COBS 2.3.



**2.48** Adding a cross reference to FG12/13 in the new COBS 2.3A will remind firms of our previous position: that for retail and professional business, we believe PFOF creates a clear conflict of interest between the clients of the firm and the firm itself, such that these arrangements are unlikely to be compatible with the inducements rule, and also risks compromising compliance with best execution rules. We believe that the core MiFID II inducements rule is consistent with, and indeed reinforces, our view on the unacceptability of PFOF arrangements.

#### **Implications for consumers**

**2.49** The enhanced inducements standards proposed above are designed to strengthen the protection of investors. This should ensure that benefits paid and received by firms do not impair their ability to act in the best interest of their clients. It will also help to ensure that firms providing advice and portfolio management are not incentivised to make inappropriate product choices. This is a particularly important investor protection measure because clients rely on providers of these services to make suitable recommendations or discretionary investment decisions in their clients' best interests. The revised standards also seek to improve the information that firms disclose to their clients about the services they receive.

#### **References**

**2.50** The existing core inducements rules are set out in COBS 2.3.

**2.51** The adviser charging rules are set out in COBS 6.1A and 6.1B.

**2.52** The new requirements for inducements are set out in:

- Articles 24(7)-(9) of MiFID II, read together with Recitals 74 to 76
- Articles 11-12 of the MiFID II delegated directive, read together with Recitals 21 to 25 and 30

**2.53** These MiFID II requirements will be transposed in COBS 2.3A.

## 3. Inducements and research

### Who should read this chapter

Firms conducting MiFID or equivalent third country business which receive research, in particular portfolio managers and independent investment advisers, and collective portfolio managers currently subject to our dealing commission rules

Providers of research, including investment banks, brokers and independent research providers

### Introduction

- 3.1** This section is particularly relevant for portfolio managers and firms that provide investment advice and wish to receive third party research, although it can also apply to other investment firms. It is also relevant to collective portfolio managers subject to our use of dealing commission rules through COBS 18.5.
- 3.2** It is also relevant for investment banks and other brokers who both provide research and offer execution services in relation to MiFID financial instruments. It will also be of interest to independent research providers.
- 3.3** This section covers our MiFID II implementation proposals for inducements and research. This will also involve replacing our current use of dealing commission rules for both MiFID portfolio managers and non-MiFID collective portfolio managers.

### Existing provisions

- 3.4** COBS 11.6 contains our rules on the use of dealing commission. These address the ability of investment managers to receive certain inducements linked to execution fees paid to brokers or other third parties, where those costs are passed on to their customers' funds. It builds on the general rule on inducements in COBS 2.3.1R.
- 3.5** The rules prevent investment managers from using dealing commissions paid to brokers to execute orders in equities or equity-related derivatives to acquire any additional goods or services in return for those charges where they are passed onto their customers' funds. The rules provide a limited exemption to this ban, to allow investment managers to acquire third party goods and services in return for execution charges paid by their clients if they are either directly related to the execution of trades, or amount to the provision of substantive research.
- 3.6** Those additional goods and services must also reasonably assist the investment manager in the provision of their services to customers and must not impair a firm's duty to act in the best interests of its customers. Investment managers must also make prior and periodic disclosures to their customers of any dealing commission arrangements they have in place.

### Drivers for change

- 3.7** We need to implement the new inducements requirements in MiFID II and the MiFID II delegated directive. These are made up of a general inducement rule for all MiFID firms, alongside stricter restrictions for firms carrying on MiFID portfolio management activity or providing investment advice on an independent basis. The European Commission's Impact Assessment for MiFID II specified the need to further restrict inducements in situations where clients place a particular reliance on a firm to act on their behalf, in order to strengthen investor protection. The MiFID II delegated directive includes specific provisions on how MiFID firms may receive third party research such that it is not deemed to be an inducement, which will therefore be particularly important to portfolio managers and independent advisers who are otherwise banned from accepting any inducements except for minor non-monetary benefits.
- 3.8** We explained in the previous Chapter that MiFID II inducements requirements for firms undertaking portfolio management activities go further than both the existing MiFID inducement rule, and the requirements in COBS 11.6. MiFID II prohibits firms who provide independent investment advice or portfolio management services from receiving any inducements in relation to these services to clients, except for minor non-monetary benefits (Article 24(7) and (8)).
- 3.9** However, the MiFID II delegated directive recognises that third party research is an important input for investment firms. It allows investment firms providing portfolio management, or other investment or ancillary services, to receive research from third parties in a way that does not contravene the inducements rules.
- 3.10** Article 13(1) of the MiFID II delegated directive states that research received from third parties shall not be regarded as an inducement for an investment firm if it is received in return for either of the following:
- a.** direct payments by the investment firm out of its own resources, or
  - b.** payments from a separate research payment account controlled by the investment firm, provided a number of conditions relating to the operation of the account are met.
- 3.11** In order to comply with option (b.) and operate an acceptable Research Payment Account (RPA) model, a firm must ensure that:
- the RPA can only be funded by a specific research charge to the client
  - they set and regularly assesses a research budget
  - they are held responsible for the account, and
  - they regularly assess the quality of research purchased based on robust quality criteria and its ability to contribute to better investment decisions
- 3.12** Provisions linked to the research charge further set out that it must:
- only be based on a research budget set by the investment firm for the purpose of establishing the need for third party research in respect of investment services rendered to its clients not be linked to the volume and/or value of transactions executed on behalf of the clients
- 3.13** The requirements in Article 13 also include disclosure obligations on firms relating to the research charge and use of the research budget, requiring both ex ante and ex post disclosures, and producing a 'research policy' to be provided to clients.

**3.14** Investment firms can use any operational arrangement to collect charges from clients, as long as the firm can still meet all of the requirements of Article 13, as emphasised in Recital 27. Further governance and oversight requirements apply to the RPA as set out in Article 13(5)-13(8). These are designed to ensure that an RPA is operated by a firm in the best interests of its clients, and that the firm is fully accountable for the use of additional research, allocating costs to clients fairly.

**3.15** Article 13(9) applies a new requirement to investment firms who provide both execution services and research goods and services to other investment firms (eg investment banks and other brokers). It includes an obligation that investment firms providing execution services must identify separate charges that only reflect the cost of executing the transaction, while the provision of each other benefit or service must be subject to a separately identifiable charge. The supply of, and charges for, those benefits or services shall not be influenced by or be conditioned by levels of payment for execution services.

### Proposals

**3.16** In the previous Chapter, we outlined our intended approach to the general inducements rule and supporting guidance in COBS 2.3A, which concerns our implementation of Article 24(8) and Article 24(9) MiFID II and Article 11 and 12 of the MiFID II delegated directive. This chapter focuses on our approach to Article 13 of the MiFID II delegated directive – which includes a qualified exclusion from the inducements rules for research. We believe this attaches most closely to our existing rules on the use of dealing commission in COBS 11.6. It addresses our proposed approach for two main groups of firms:

- MiFID investment firms and firms providing investment advice who may be otherwise exempt under Article 3
- Non-MiFID firms carrying out collective portfolio management that are currently subject to our dealing commission rules through COBS 18.5

**3.17** However, the MiFID II research and inducements provisions have wider relevance to investment firms than our current dealing commission rules, which focus on investment managers (including collective portfolio managers via COBS 18.5). Other investment firms can choose to comply with Article 13 of the MiFID II delegated directive in order to receive research without it constituting an inducement, including investment firms offering independent investment advice that are also subject to a more restrictive inducements rule in MiFID II alongside portfolio managers. It also places requirements on firms who offer execution services alongside the supply of research (eg sell-side brokers).

**3.18** For this reason, and due to its integral link to the MiFID II inducements regime, we propose a new COBS section 2.3B to implement the provisions on the receipt of research by investment firms, to place it alongside the main MiFID II inducements rules in COBS 2.3A. This would replace COBS 11.6 for investment managers carrying out MiFID portfolio management. We propose to create a new COBS 2.3C to include the provision and recitals which apply to investment firms *providing* execution and research services, since these will be different firms.

**3.19** The more restricted inducements regime in MiFID II also applies broadly to any material third party benefits received by a firm providing portfolio management services or independent investment advice *involving any* MiFID financial instrument. So it also applies more widely than our current dealing commission rules in COBS 11.6, which only apply to third party benefits received by investment managers in relation to executing orders on behalf of their customers in equities or equity-related derivatives.

**Application to MiFID investment firms and firms providing investment advice**

**3.20** Our proposed approach to transpose the MiFID II delegated directive in this area for MiFID investment firms and firms providing investment advice is as follows:

- Transpose the requirement in Article 13(1) in a new COBS 2.3B section that will link to the new inducements rules (to be copied out in a revised COBS 2.3A). For MiFID firms, the requirements in Article 13(1) have the following effect:
  - For MiFID firms providing portfolio management or independent investment advice, complying with these provisions will be the only means by which they can receive third party research in relation to their services to clients without breaching the inducement rules, unless such research is a minor non-monetary benefit.
  - Aside from research, no other material third party non-monetary benefits can be received by portfolio managers and independent investment advisors under MiFID II in relation to these services.<sup>14</sup>
  - For firms providing other MiFID investment services, they may choose to comply with Article 13(1) in order to receive third party research, but alternatively these firms could treat it as an inducement and may be able to accept it if they demonstrate it meets the requirements of Article 24(9) MiFID II, and Article 11 of the MiFID II delegated directive.
- Transpose the provisions in Article 13(2-8) setting out the more detailed requirements linked to the use of an RPA. This will primarily involve minor re-ordering and structuring of certain provisions to improve clarity and accessibility for firms.
- Transpose as guidance:
  - Recital 27, to the extent that it provides additional detail on how firms should operate a research payment account and collect charges
  - Recital 28 on research that can be paid for from research payment accounts, if investment firms choose to use this option
  - A link pointing to guidance in COBS 2.3A that will transpose part of Recital 29, which provides examples of material that may be considered and accepted as a minor non-monetary benefit, rather than as research
- Provide guidance on the application of the section to clarify the link between COBS 2.3B and the inducements rules set out in COBS 2.3A.
- Provide guidance on approaches firms could consider to be compliant with certain aspects of the inducements and research requirements. We believe this guidance is consistent with the intention of the MiFID II reforms and does not create new obligations. The guidance we propose, which we also discuss further below, covers:
  - the level at which budgets should be set to inform the research charges to clients where firms use an RPA
  - the client money treatment of RPAs

<sup>14</sup> This means execution-related goods and services, which our existing rules in COBS 11.6 allow to be received as a benefit linked to execution charges paid to brokers, will no longer be able to be supplied as a benefit linked to execution charges or costs passed on to the investment managers' clients.

- the interaction of the ‘minor’ non-monetary benefits exemption with the requirements for the receipt of substantive research goods and services
- Provide guidance to indicate to firms the relevant links to provisions copied out in revised COBS 2.3 on the minor non-monetary benefits exemption (Article 12(2) MiFID II delegated directive).
- Retain limited provisions from COBS 11.6 as follows:
  - An amended form of COBS 11.6.7G and relevant items listed in 11.6.8G that we consider do not constitute research.<sup>15</sup> This distinction will continue to be relevant to how investment firms can use a research payment account on behalf of clients, if they choose to adopt them, under Article 13(1).
  - Retain an amended form of COBS 11.6.11G to indicate that firms should not enter into any arrangements relating to their receipt of research that would compromise their ability to meet their best execution obligations.
- Create a new record-keeping requirement linked to the new MiFID II requirements, to ensure firms can evidence their compliance if seeking to receive research under the new provisions and so not treat it as an inducement.
- Amend COBS 11.1.3R, which refers to the use of dealing commission and the application of the chapter, in line with the above changes.
- Delete remaining provisions in COBS 11.6 and remove this section from the dealing and managing chapter.
- Transpose the new requirement in Article 13(9) into a new section COBS 2.3C. This would apply to investment firms which offer execution of orders and other goods and services to other investment firms. We will also transpose Recital 26 as guidance linked to this provision.
- We will also consider further guidance if stakeholder responses indicate a need for these (see questions ), or consider new or amended guidance to that proposed above if ESMA publishes Level 3 material in relation to these aspects of MiFID II at a later date.

### ***Aspects of the inducements and research rules***

#### ***Setting budgets for use of RPAs and client-specific research charges***

- 3.21** While the MiFID II delegated directive requires a specific charge to a client based on a research budget, it does not state that a budget has to be set at an individual portfolio level. So, we consider firms can set a research budget that applies to a number of client portfolios or funds where they share similar investment strategies and objectives, such that they can benefit from the same inputs based on the asset allocation and underlying instruments they can invest, or are invested, in. This may allow firms to set a budget at a desk-level or strategy level provided the individual and collective portfolios subject to the budget share sufficiently similar research needs. A firm may choose to set a top-down, firm-level research budget as part of a process by which it then sets specific budgets at the level of groups of portfolios based on a bottom up assessment of research needs.

<sup>15</sup> This does not preclude the possibility that some items specified as not constituting research in any revised guidance could be a minor non-monetary benefit if an investment firm believes it meets Article 12(2) MiFID II delegated directive.

**3.22** Firms must ensure the specific charge to a client and the corresponding budget that charge is contributing towards does actually pay for research which can assist its investment decisions for the client. Firms should document and be able to justify how they have grouped client portfolios for this purpose. Firms must have robust systems and controls to ensure a fair allocation of research costs in the best interests of their individual clients. A group of portfolios for which a shared budget is set should not be so broad that portfolios with substantively different research needs are subject to the same budget.

**3.23** Client-specific charges must still be estimated and disclosed upfront, based on the relevant pre-set budget. The firm should have a transparent methodology for how they determine a fair allocation for these purposes. This may involve a pro-rated split of a research budget across the identified group of client portfolios to derive an estimated charge for each client.

***Funding an RPA by collecting charges alongside transaction costs***

**3.24** Under the MiFID II RPA regime, in our view using a single RPA to manage each separate research budget set by the firm would be the most effective way to meet the requirements. MiFID II also allows the firm to collect a client research charge alongside a transaction charge or cost. However, research charges deducted in this way are still required to accrue into a separate RPA used by the firm for the particular budget that the portfolio is subject to. Operationally, this will require changes to current Commission Sharing Agreement (CSA) accounts to ensure adequate control and oversight by the investment firm as required by the RPA structure. We believe any mechanism linked to transactions must ensure:

- research charges deducted through a broker alongside transaction fees or costs are ceded (or 'swept') to an RPA immediately following the associated transaction (eg daily or within the settlement period for the transaction), although detailed reconciliations may take place less frequently, eg weekly or monthly
- except when the research charge temporarily passes through an executing broker, an investment firm's RPA monies are to be ring-fenced and separately identifiable from the assets of any third party entity they use to hold and administer the RPA (which can include a broker), prior to the investment firm instructing payment to a research provider
- payments from the RPA must be made in the name of the investment firm based on their instructions, and must be fully audited, and
- RPA arrangements allow the investment firm to deduct research charges and manage those funds in a way that corresponds to the budget set for a group of client portfolios and to rebate RPA funds to those same clients if significant amounts are unspent at the end of a budget period

**3.25** These features should ensure consistency with requirements for a firm to control and be held responsible for the RPA, and reduce potential conflicts of interest in managing RPA funds. It will ensure the investment firm retains a strong behavioural incentive to account for the use of RPA monies, and not treat it as money already spent or given up to an executing broker. It will create a clear contrast and step change to practices we have seen in previous supervisory work, where some firms did not robustly control and scrutinise their use of dealing commission using CSAs.

**3.26** While MiFID II permits an investment firm to collect research charges from their clients alongside transactions costs or charges, it does not in our view allow brokers providing research to retain charges directly for the research they provide to the investment firm alongside a transaction commission paid by that firm's clients. The research charge must always go to the RPA, and can then be paid out to the relevant broker. Any payment for research should be justified based on



a firm's quality criteria and valuation approach, and corresponding prices offered by providers for agreed levels of goods and services. It should ensure a procurement process for research that is separated from execution costs and decisions.

- 3.27** As noted above, we will review our approach and guidance proposed in this CP, or consider additional provisions in due course if ESMA publishes Level 3 material in this area.

***Research and minor non-monetary benefits***

- 3.28** Recital 29 in the MiFID II Delegated Directive provides an indication of items that may be considered as minor non-monetary benefits. These include 'non-substantive material or services consisting of short term market commentary on the latest economic statistics or company results for example.' This does not depend on the label attached to such material, but requires a consideration of the substance of its content. It is for the receiving firm to make their own assessment, and if material does appear to be substantive, value-added research, and so is not minor in nature and scale, a firm will need to either pay for it under the new research requirements or not accept it (where they are subject to the restriction on inducements).

- 3.29** The fact that a provider seeks to label material as 'non-substantive' or as short-term market commentary or colour, or that it is produced by a particular area of a firm (eg a trading desk), will not automatically mean that it can be accepted as a minor non-monetary benefit by the recipient. Research related to fixed income or other non-equity instruments is equally subject to such considerations and the restriction on material inducements for the relevant firms.

***Application to firms carrying out collective portfolio management (CPM)***

- 3.30** To retain consistency with our existing approach of applying our use of dealing commission rules in COBS 11.6 to all forms of investment management activity, we are consulting on the basis of applying the research and inducements requirements in MiFID II to MiFID exempt UK authorised firms carrying out investment management of collective investment schemes, which includes:

- UCITS management companies
- full-scope UK AIFMs
- small authorised AIFMs and residual collective investment scheme (CIS) operators
- incoming EEA AIFM branches

- 3.31** These firms are currently subject to COBS 11.6 under application provisions set out in COBS 18.5 (within our Specialist Regimes chapter). There is also a cross-reference to the application provisions in COBS 11.6.2AG. We propose a similar approach in substance based on the new MiFID II inducements and research standards. This will involve:

- Creating a new rule in COBS 18.5, and also in proposed new sections COBS 18.5A and 18.5B (see Chapter 12 below). This will restrict small authorised UK AIFMs and residual CIS operators, full-scope UK AIFMs and incoming EEA AIFM branches, and UCITS management companies respectively from receiving inducements related to executing transactions on behalf of the fund(s) they manage. This rule will then permit an exemption to this restriction if they either:
  - comply with the transposed MiFID II delegated directive provisions on inducements and research (new COBS 2.3B), that permits the receipt of research such that it will not be considered an inducement, or



- if the inducement is a minor-non monetary benefit meeting the transposed MiFID II delegated directive provision in COBS 2.3A

- Deleting all references in COBS 18.5 to COBS 11.6, which itself will be deleted

**3.32** We also intend to make further modifications to the provisions within COBS 2.3B when applied to collective portfolio managers to ensure, in particular, that any disclosure requirements are appropriate in a funds context.

**3.33** In addition, as part of COBS 18.5, we also currently turn off certain disclosure requirements in our dealing commission rules completely for full scope UK AIFMs of internally managed AIFs. We welcome views from stakeholders in response to this CP on whether a similar dis-application of certain disclosure aspects where firms use a research payment account under the new research and inducements provisions may be appropriate for these types of funds. If responses provide evidence that specific requirements are not proportionate or meaningful for this type of activity, we will consider creating a rule in COBS 18.5A to modify the application of aspects of COBS 2.3B accordingly in the final Handbook proposals.

**3.34** Since this extended application goes beyond the scope of MiFID II and our legal duty to implement EU legislation, we have included a CBA on these proposals in Annex 2. However, based on industry engagement, we think most firms expect this approach. The vast majority who do both MiFID individual portfolio management and non-MiFID collective portfolio management intend to apply common standards and, accordingly, implement common systems and controls across their business.

#### **Implications for firms**

**3.35** In considering MiFID II reforms and our implementation approach, it is important for firms to consider the key principles and outcomes these changes are designed to achieve, which are to ensure:

- investment firms account for third party research as a fixed, predictable cost, not linked to execution costs or charges or subsidised through other services
- research becomes a core management cost or is fully transparent to underlying investors, removing the inducement and conflict of interest risk for firms
- a transparent, priced research market emerges where recipients and providers establish upfront pricing based on agreements linked to the quality and quantity of goods and services to be supplied, and the expected benefit to investors

**3.36** MiFID portfolio managers, independent advisors and collective portfolio managers will need to change their policies, systems and controls if they currently receive research from third parties relating to these services to clients, and they wish to continue to receive it. They will need to make a commercial decision about the approach they take to acquire third party research from 3 January 2018. If they choose to apply a research charge to their clients and use a research payment account (RPA), they will need to ensure their internal process and controls can meet the relevant requirements in Article 13 MiFID II delegated directive (and replicated in our COBS Handbook). If they choose to pay for research directly, they will need to be able to evidence this and show that it is not reflected in any execution costs and charges or other fees paid to brokers.

- 3.37** For UK investment managers, those who have already adopted best practices in line with our recent dealing commission review (reported in DP14/3)<sup>16</sup> should be well placed to adapt to the operation of RPAs. For example, the requirement to set a budget for research, and to establish internal governance procedures to assess the quality of research and value it in the client's best interests are similar to our current expectations under COBS 11.6.
- 3.38** UK investment managers will have to extend or establish new arrangements to ensure they can make payments to receive research when managing and transacting in non-equity or equity related derivative instruments. Investment firms will need to make a commercial decision as to whether they pay for this research directly or set up similar 'research payment accounts'. We understand that some third party service providers are exploring mechanisms to allow firms to deduct a research charge from clients alongside a transaction in non-equity instruments, even though explicit dealing commission charges are not currently used in some markets (instead transaction costs are included in broker spreads or additional mark ups).
- 3.39** Other firms may have to put in place new processes if they wish to use an RPA mechanism, including firms providing investment advice. Investment managers and independent advisors will also need mechanisms to enable them to block the receipt of unsolicited research or other benefits that would otherwise constitute an inducement in relation to their services to clients. This will include any benefits an investment manager may currently accept under COBS 11.6 as an execution-related good or service.<sup>17</sup> If an investment manager does currently accept execution-related benefits that are not research, then they would need to either:
- Cease accepting them in relation to their investment management services to clients if they are material in nature,
  - Demonstrate that they are a minor non-monetary benefit (although this is likely to be very limited in scope), or
  - Pay for services with the firm's own money. The latter approach is consistent with the fact that execution-related services are likely to be necessary to providing the general service of portfolio management and so should be treated as a core cost of business for the firm.
- 3.40** Firms who provide both execution and research services will have to identify separate charges for their services. This means a broker will no longer be able to charge a bundled execution rate, which the portfolio manager agrees and passes on to their clients as trading costs, in return for unpriced research goods and services provided as a benefit to the manager. Brokers may need to review their business model to develop charging models and service agreements with investment firms for the supply of research, and to adjust their execution costs and charges accordingly. Having to identify separate charges for discrete services will create more competitive pressure on firms to justify the value for money of each component.
- 3.41** Execution-only brokers or independent research providers who already have more specialised businesses should find their ability to compete in their respective markets is improved, since there will be more specific price points for discrete services.

<sup>16</sup> Discussion Paper 14/3 *Discussion on the use of dealing commission regime: Feedback on our thematic supervisory review and policy debate on the market for research* (July 2014).

<sup>17</sup> COBS11.6.3R(3)(c)(i). From our supervisory work, we believe relatively few firms use this exception compared to that for substantive research, due to the need for an execution-related good or service to have a direct link to a specific transaction and because the benefit must be provided between the point at which an investment manager makes an investment decision and the conclusion of the investment transaction(s) (see COBS 11.6.4E).

- 3.42** We anticipate that operational changes that investment managers, in particular, may need to make to meet the new MiFID II approach may be complemented by new services being offered by third parties. This could include administration of RPAs, which may involve holding RPA funds on behalf of a portfolio manager, performing basic due diligence on research providers to confirm they are legitimate, and processing payments. New third party business models may also include platforms facilitating the distribution, pricing and sale of third party research.<sup>18</sup>
- 3.43** In DP14/3 we provided a high-level cost benefit and competition analysis based on the prospect of a possible reform to require investment managers to separate research from execution arrangements, and encourage pricing of research by sell-side brokers. We concluded from this analysis that there would be a net benefit to consumers and competition in the investment management and research sectors, which would outweigh costs or negative impacts.<sup>19</sup>
- Implications for consumers**
- 3.44** The new MiFID II inducement standards improve investor protection for customers receiving portfolio management or independent advice services. This is because they remove the potential influence that receiving valuable non-monetary benefits from third parties may have on firms' execution decisions.
- 3.45** The costs of any external research an investment manager or independent investment advisor firm chooses to consume will in future be included in upfront charges to the client, which are more transparent and will better reflect the nature of research as a core component and cost when making investment decisions or recommendations. An investment firm will have to clearly account for and justify the benefits to their clients where they charge them for external research separately.
- 3.46** By extending requirements to collective portfolio management, we are seeking to ensure investors in funds or other forms of collective investment scheme performing economically equivalent activities are subject to the same investor protection standards and that cost and charges are more transparent across different types of portfolios and services. This is consistent with the commercial models of many asset management firms, whereby individual and collective portfolios are managed side-by-side, with investment decisions taken for groups of portfolios and funds together, and also transactions aggregated across portfolios to create benefits from economies of scale. It will ensure that where a firm carries out both individual and collective portfolio management, there is no incentive to fund research through dealing commissions charged to their funds, which may also benefit individual portfolios. This could occur if different standards were applied and firms wished to avoid paying for research themselves or with more explicit charges. A common approach also removes scope for competitive distortions in the UK asset management sector.
- 3.47** Portfolio management services in the EU, in particular, should become more cost-efficient and price-competitive as a result of MiFID II reforms. Transaction costs passed on to clients by portfolio managers or independent advisors, in addition to upfront management or advisory fees, should fall since they will only reflect the costs of execution or dealing. This will also help investment firms to better monitor and analyse the quality of execution provided by other investment firms or venues to which they transmit orders.
- 3.48** Portfolio managers and independent investment advisors, as wholesale consumers, will receive more transparency on the charges and costs of services provided by brokers and research

<sup>18</sup> We have already seen examples of new intermediary platforms facilitating buy-side access to priced research products or subscriptions from a range of service providers, which help both buy-side firms to access research on a priced basis and allows independent providers a distribution channel through which to advertise and sell their products and services.

<sup>19</sup> DP14/3, Chapter 5.

firms. We expect this to drive improvements in the cost and quality of research, with portfolio managers and advisors becoming more selective in the research they chose to obtain on behalf of their clients. A more open, competitive research market should also encourage new entrants and innovation in pricing and distribution models. This flexibility in provision will ensure cost-effective access to research is maintained for investment firms of all sizes.

- 3.49** We consider that the MiFID II reforms will improve the quality of research coverage over time compared with the current market. This will have a further benefit for corporate issuers, who are the subject of much third party research produced for the use by portfolio managers to inform their investment decisions.

### Discussion

- 3.50** We think that copying out MiFID II provisions on how portfolio managers, other MiFID firms, and firms providing investment advice can receive research under the new inducements requirements as a new COBS 2.3B section, replacing our UK dealing commission rules in COBS 11.6 for MiFID investment managers, can help firms to understand the relationship to the wider MiFID II inducements rules, and make the new approach clearer given its extended application beyond investment managers. However, we will copy certain guidance from our previous dealing commission regime in COBS 11.6 into the new COBS 2.3B section, because we think it remains relevant under the new MiFID II inducements and research approach.

- 3.51** Likewise, extending these obligations to collective portfolio managers by new provisions in COBS 18.5, and signalling this with guidance in COBS 2.3B, will provide a clear structure for firms.

- 3.52** Setting out obligations for firms providing execution and research services in a separate COBS 2.3C will ensure the specific application of these provisions is clear.

### References

- 3.53** The existing rules are in COBS 11.6 and link to COBS 2.3.
- 3.54** The new MiFID II requirements on payment for research are set out in:
- Article 24(8) of MiFID II
  - Article 13 and Recitals 26-30 of the MiFID II delegated directive

- 3.55** Draft provisions implementing this proposal are in new COBS 2.3B and COBS 2.3C. Application provisions to switch on COBS 2.3B for collective portfolio managers will be contained in COBS 18.5, COBS 18.5A and COBS 18.5B. COBS 2.3B will link to new MiFID II general inducement provisions, especially the MiFID II delegated directive Articles 11 and 12, which will be transposed into COBS 2.3A.

### Questions

- Q9: Do you agree with our approach to transpose the MiFID II proposals for the receipt of research linked to the new MiFID II inducement rules as a new COBS 2.3B? If not, please state why and provide any suggestions for an alternative approach.**

- Q10:** Do you agree with our approach to extending the research and inducements requirements to firms carrying out collective portfolio management activity? If not, please give reasons why.
- Q11:** Do you agree with proposals to retain some guidance provisions from the existing COBS 11.6 in the new COBS 2.3B section, where they continue to be relevant under the new proposals? If not, please give reasons why.
- Q12:** Do you have any views on areas where we have proposed new guidance provisions to clarify our interpretation of steps firms could take to ensure compliance with the new inducements and research proposals and the detail of the proposals? If not, please give reasons why and any alternative suggestions.
- Q13:** Do you have any views on whether further guidance provisions are needed to clarify other aspects of the new inducements and research proposals and how firms should interpret and implement changes to comply with these provisions? If so, please detail specific aspects on which you think FCA guidance is desirable.
- Q14:** Should we consider any modifications to the requirements linked to the use of RPAs under the inducements and research provisions for full scope UK AIFMs of internally managed AIFs? If so, please provide details on what modifications we should consider and why.
- Q15:** Should we apply the new MiFID II inducements standards to firms carrying out non-discretionary portfolio management activity (as defined in our Handbook glossary), including where they receive third party research, in the same way as for other types of portfolio management? Please provide evidence to support your views.

## 4. Client categorisation

### Who should read this chapter

Firms conducting MiFID or equivalent third country business, and firms conducting non-MiFID business, local authorities and other public sector bodies.

### Introduction

- 4.1** This chapter outlines our implementation approach to changes to the existing client categorisation regime introduced by MiFID II. The MiFID regime uses client ‘categories’ to recognise that investors have different levels of experience, knowledge and expertise, and it tailors regulatory protections accordingly.
- 4.2** The financial crisis highlighted limits in the ability of non-retail clients to fully appreciate investment risks. To address this, MiFID II introduces a number of key changes to the existing client categorisation regime. These include the extension of additional conduct of business requirements to business with Eligible Counterparties (ECPs).
- 4.3** MiFID II seeks to increase regulatory protections for public bodies, specifying that only certain types of public body can be categorised as ECPs. It clarifies that elective professional clients will no longer be able to request treatment as ECPs and introduces new procedural requirements to be adhered to by firms when opting-up clients to become ECPs (including written confirmation, investor warnings).
- 4.4** Finally, MiFID II categorises local authorities as retail clients by default, with the ability to opt-up to professional client status (“elective professional clients”). We also have discretion to adopt alternative or additional criteria to assess the expertise and knowledge of local authorities requesting treatment as professional clients.
- 4.5** The paragraphs below set out our proposed approach to implementation for both MiFID and non-MiFID scope designated investment business, including where we propose to exercise discretion with respect to local authorities.

### Existing provisions

- 4.6** Our Handbook rules on client categorisation are set out in COBS 3.
- 4.7** The client categorisation rules also apply to non-MiFID scope business, with some exceptions. For example, the ‘quantitative test’ for opting-up to professional client status in COBS 3.5.3R (2) does not apply to non-MiFID scope business.

- 4.8** Currently, national governments, including public bodies that deal with public debt, may be categorised, for the purposes of carrying out ECP business,<sup>20</sup> as per se ECPs under COBS 3.6.2R(8). National or regional governments, and public bodies that manage public debt, may be categorised as per se professional clients under COBS 3.5.2R(4).
- 4.9** COBS 3.6.4R(1)(b) allows elective professional clients to opt-up to ECP status for either MiFID or non-MiFID scope business. COBS 3.6.6R allows firms to obtain the client's confirmation that it wishes to be treated as an ECP, either in the form of a general agreement or for each individual transaction. However, for MiFID scope business, firms must also obtain **express confirmation** that the client agrees to be treated as an ECP.
- 4.10** Local authorities are categorised, for the purposes of MiFID scope business, as per se professional clients where they meet the MiFID Large Undertakings test in COBS 3.5.2R(2). If they do not satisfy this test, they are categorised as retail clients but may opt-up to professional client status if they fulfil the 'opt-up criteria' in COBS 3.5.3R. For non-MiFID scope business, local authorities are automatically categorised as per se professional clients under COBS 3.5.2R(3)(f).

### Proposals

- 4.11** In line with MiFID II, we will amend COBS 3.6.2R(8) to clarify that only a national government or a public body dealing with public debt **at national level** can be categorised as a per se ECP. We will also amend COBS 3.5.2R(4) to clarify that only a national or regional government or a public body which manages public debt **at national or regional level** can be categorised as a per se professional client.
- 4.12** To give effect to MiFID II's bar on opting-up elective professional clients to ECP status, we intend to delete COBS 3.6.4R(1)(b). We will also insert new text to implement the new procedural notification requirements (written confirmation, investor warnings) for firms who opt-up per se professional clients to ECP status.
- 4.13** To give effect to MiFID II's retail categorisation of local authorities, we intend to delete COBS 3.5.2AR. We also propose to exercise our discretion to introduce either additional or alternative quantitative opt-up criteria for local authorities. Under our proposals, firms would be required to apply the following tests and procedural steps when opting-up local authority clients to professional client status:
- The *qualitative test* – firms must undertake an adequate assessment of the expertise, experience and knowledge of the client to give reasonable assurance in light of the nature of the transactions or services envisaged, that the client is capable of making his own investment decisions and understanding the risks involved (COBS 3.5.3R(1))
  - A re-calibrated *quantitative test* (based on COBS 3.5.3R(2)) – the criteria in paragraph (a) **and** the criteria in either paragraph (b) or (c) must be satisfied:
    - (a) the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments, exceeds **£15,000,000**
    - (b) the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters
    - (c) the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged

<sup>20</sup> Otherwise, they will be categorised as per se professional clients, as set out later in this paragraph.



- The *procedural requirements* in COBS 3.5.3R(3).

**4.14** We propose to also clarify that the retail categorisation will apply to local authorities who act as pension fund administrators in the same way as it will to those acting in their main capacity, ie as treasury managers.<sup>21</sup> The first of these refers to the portfolio management activities of administering entities of the local government pension scheme, the vast majority of which typically form part of the local authority (on behalf of which it manages staff pension funds). Accordingly, local authorities acting in this capacity will be able to opt-up under the same conditions as local authorities acting in their main capacity as treasury managers (as set out in the previous paragraph).

**4.15** However, firms will be required to categorise the local authority separately depending on the capacity in which it is acting (ie either as treasury manager or a pension fund administrator), and apply the opt-up criteria in paragraph 4.13 separately to each business line. As such, when firms categorise local authorities acting in their main capacity as treasury managers, the quantitative test would not include the assets of the pension fund, which should be considered separately. Equally, when categorising local authorities acting in their capacity as the administrator of a pension fund, the quantitative test would be applied only to the assets of the pension fund. So the assets from the treasury management function would not be included within the quantitative assessment.

**4.16** Where firms provide MiFID or equivalent third country business to local authorities and municipalities located in another EU Member State or an EEA State, we propose that firms should defer to the status of the local authority or municipality as determined by the law or measures of the EU/EEA state in which that undertaking is established. For example, a UK firm carrying out business with, for example, a French local authority should categorise the local authority according to the specific criteria applied in that Member State.

**4.17** We also propose, as explained in the Discussion section of this chapter below, to extend the MiFID II requirements (including in our exercise of discretion) to non-MiFID scope business including business conducted by Article 3 firms. We propose to apply all of the following to non-MiFID scope business:

- the narrowing of the scope of clients who can be categorised as ECPs
- the bar on opting-up elective professional clients (including the application of the procedural notification requirements)
- the re-categorisation and revised opt-up criteria for local authorities (including local authorities acting as pension fund administrators)

**4.18** As highlighted above, the client categorisation rules in COBS 3 already generally apply to non-MiFID scope business, with some limited derogations (see, for example, COBS 18.2.3R in relation to energy market and oil market activity). The proposals as set out in this chapter will apply to non-MiFID scope business in the same way as to MiFID scope business.

**4.19** To extend these proposals to non-MiFID scope business, we will delete COBS 3.5.2AR to ensure that local authorities can no longer be categorised as per se professional clients for non-MiFID scope business. Other handbook changes relating to the MiFID II reforms to the opt-up process for ECPs and to local authorities will then be applied to both MiFID and non-MiFID scope

<sup>21</sup> In a document issued at the time of the implementation of MiFID the FSA stated that “where a local authority is acting in its capacity as the administrator of a pension scheme, it is likely to fall under the limb of the definition covering pension funds or their management companies (COBS 3.6.2R(5))”.



business. This will include firms which are exempt under Article 3 of MiFID II; namely financial advisers, corporate finance boutique firms and venture capital firms. For the remaining elements of the client categorisation regime, application with some exceptions will be retained.

#### **Implications for firms**

- 4.20** As elective professional clients will no longer be able to opt-up to ECP status, firms will have to re-categorise their ECP clients who have been opted-up from elective professional client status. Firms will also need to amend their opting-up processes for ECPs to comply with the procedural notification requirements (ie in the case of per se professional clients only).
- 4.21** For both MiFID and non-MiFID scope business, the re-calibrated quantitative criteria for local authorities mean that firms will have to review the categorisation of their existing local authority clients in order to ascertain what their proper categorisation should be (ie as retail or elective professional clients).
- 4.22** Given the differences in the way in which COBS requirements apply to the different client categories, firms may have to review the broader impact that this change may have on their business as some clients may need to be re-categorised. This may involve changes to firms' internal systems and controls. Those firms with local authority clients who do not meet the re-calibrated quantitative criteria to become professional clients and which are not authorised to provide services to retail clients need to consider what permissions they need in order to continue servicing those clients.

#### **Implications for consumers**

- 4.23** MiFID II's changes to the categories of client who can opt to become ECPs (ie the prohibition on opting-up elective professional clients) mean that some clients will benefit from additional regulatory protections if they remain as elective professional clients, although they may be subject to additional processes from a firm perspective, such as consent procedures. However, their ability to access financial markets will not be fundamentally affected.
- 4.24** We propose to exercise our discretion to apply alternative quantitative criteria to local authorities. The re-calibrated quantitative threshold (as set out in paragraph 4.13) is specifically designed to ensure that only smaller, less sophisticated local authorities (such as parish and town councils acting in their treasury function capacity) are likely to fall below the required threshold. We believe this threshold will serve to identify local authorities for whom more complicated financial services may not be appropriate given their level of resources and potentially lower level of knowledge and expertise, and therefore should be treated as retail, rather than professional clients. The resultant increased regulatory protections for these local authorities should reduce the risk of them being sold services or products which they may not understand, and prevent future cases of local authorities incurring significant losses, as seen in the recent past. This change should also have the benefit of enhancing investor protections for local authority treasury reserves.
- 4.25** The threshold is also intended to ensure that local authorities with the requisite resources and expertise and knowledge (including local authorities acting as pension fund administrators) can opt-up to become professional clients. Furthermore, those local authorities who meet the criteria (as set out in paragraph 4.13) will benefit from added regulatory protections compared with per se professional clients, since elective professional clients cannot be presumed to possess the market knowledge and experience comparable to a per se professional client. This proposal strikes a balance between ensuring local authorities acting on behalf of the beneficiaries of the Local Government Pension Scheme can access a wide range of investment opportunities, while providing enhanced regulatory protections compared to their current status.

**4.26** Local authorities classified as retail clients may be unable to access the services of certain investment firms (eg alternative asset managers without retail permissions). This will be mainly limited to smaller local authorities and more complex products or services, and should not affect local authorities acting as pension fund administrators. We believe this potential restriction is proportionate given the likelihood that such local authorities are less sophisticated consumers (as discussed further below).

#### **Discussion**

**4.27** We share the view underpinning the MiFID II reforms that elective professional clients should no longer be eligible to become ECPs, given that a number of important conduct of business requirements do not apply to ECPs (eg the rule on inducements and the obligation to provide best execution). Protections such as these are likely to be more important for such clients, who will be classified as retail clients at the outset, and therefore cannot be presumed to have the market knowledge and experience comparable to a per se professional client.

**4.28** There have been significant concerns in recent years with respect to alleged mis-selling involving local authorities, so we are keen (as set out above) to ensure that only those with the requisite experience, knowledge and expertise can be treated as professional clients. As is the case with other client types, the size of a local authority often aligns with its level of knowledge and expertise. Further, the size of the local authority tends to reflect the resources and facilities it has available to it (eg to pay for in-house expertise or investment advice). In our view, therefore, the current portfolio size requirement of €500,000 in point (b) of the standard quantitative test for elective professional clients is not appropriately calibrated for local authorities; this test was primarily devised for high-net worth clients and small corporate entities, rendering it a less meaningful threshold for local authorities, most of which would easily meet it.

**4.29** The increased portfolio size requirement of £15m is proposed on the basis that £10m typically reflects the average portfolio size of smaller local authorities. We consider that this threshold is set at a more meaningful level, given the relative size of local authorities' resources. This requirement, combined with the qualitative test, is aimed at precluding smaller, less sophisticated local authorities acting in their main capacity as treasury managers from being opted-up inappropriately. Taken together, these requirements should ensure that local authorities are properly assessed on both the quantitative and qualitative elements of their profile – a fundamental building block of the client categorisation regime. We are, however, aware that this increased portfolio size requirement of £15m may preclude some smaller, less sophisticated local authorities (eg parish and town councils) from being able to opt-up. In our view, however, these require more regulatory protection than larger local authorities as they will be less likely to be able to absorb losses, or have the in-house expertise or the resources available to them to fully appreciate the risks involved with investing in complicated financial products.

**4.30** Separate application of the opt-up criteria for local authorities dependent on the capacity in which they are acting (ie either as treasury managers or as pension fund administrators) is proposed to ensure that treasury reserve funds and pension reserve funds are not co-mingled for the purposes of meeting the quantitative test. If this were the case, all local authorities could opt-up to professional client status based on their pension fund reserves alone, meaning that small treasury management functions might be inappropriately opted-up.

**4.31** Our proposal in respect of categorising local authorities located in other EU/EEA States is in line with the European Commission's original policy intention, that Member States should be able to design specific opt-up criteria for local authorities within their territory, given the apparent differences in local government structures across the EU. Our proposal would ensure that local authorities across the EU/EEA are categorised by firms in accordance with the criteria deemed appropriate for local government in the territory in which they are located.

**4.32** The rationale for extending our proposals to non-MiFID scope business is based on our view that the same regulatory protections should apply to non-MiFID scope as to MiFID scope business. For example, clients investing in units of a private equity fund with an alternative investment fund manager (non-MiFID scope) should benefit from the same regulatory protections as clients investing in a transferable security with a MiFID investment firm (MiFID scope). The same rationale applies to our decision to extend the quantitative test for opting-up local authorities to professional client status to non-MiFID scope business.

#### References

**4.33** Existing provisions are set out at: COBS, 3.5.2, COBS 3.5.3, COBS 3.5.7G, COBS 3.6.2, COBS 3.6.4, COBS 18.2.3, 18.3.3, 18.6.

**4.34** The new requirements are as follows:

- Recital 104, Article 24(5), Article 30 (1), Article 30(2), Annex II.1 (1) and (3), and Annex II.II.1, paragraph 1, 3, 5 & 6 of MiFID II
- Article 71 of the MiFID II delegated regulation.

**Q16: Do you agree with our approach to revise the quantitative thresholds as part of the opt-up criteria for local authorities by introducing a mandatory portfolio size requirement of £15m? If not, what do you believe is the appropriate minimum portfolio size requirement, and why?**

**Q17: Do you agree with our approach to extend these proposals to non-MiFID scope business? If not, please give reasons why.**

## 5. Disclosure requirements

### Who should read this chapter

Firms conducting MiFID or equivalent third country business, and firms conducting non-MiFID business (including Article 3 firms).

Consumers and consumer organisations.

### Introduction

- 5.1** In this chapter we propose changes to the disclosure rules in the Conduct of Business sourcebook (COBS). These changes will implement disclosure requirements introduced in the MiFID II Directive and reflect the requirements in the MiFID II delegated regulation.
- 5.2** In this chapter, ‘MiFID business’ refers to MiFID or equivalent third country business, or the MiFID-related business carried on by Article 3 firms.<sup>22</sup> And, ‘non-MiFID business’ means the business carried on by firms that is not MiFID business, or the MiFID-related business of an Article 3 firm.
- 5.3** We propose to amend disclosure provisions in the following chapters: GEN 1 (Appropriate regulator approval and emergencies), COBS 1 (Application), COBS 2 (Conduct of business obligations), COBS 4 (Communicating with clients, including financial promotions), COBS 6 (Information about the firm, its services and remuneration), COBS 14 (Providing product information to clients) and COBS 16 (Reporting information to clients). We also propose to introduce new rules, and new chapters or sections of chapters: COBS 2.2A, COBS 4.5A, COBS 6.1-A, COBS 14.3A and COBS 16A, which will apply in relation to MiFID business.
- 5.4** Our proposed provisions are designed to ensure appropriate investor protection, provide information to clients and potential clients, and provide for reporting to clients. We explain the disclosure requirements applying to firms, in relation to the provision of advice, in Chapter 7.
- 5.5** Building on the regulatory framework introduced by MiFID, the new MiFID II disclosure provisions are designed to increase client protections, in particular for non-retail clients. These changes are needed as the financial crisis demonstrated limits in the ability of certain types of non-retail client to appreciate investment risks.<sup>23</sup>
- 5.6** MiFID II strengthens the regulatory protections available to professional clients and ECPs. For professional clients, it applies disclosure requirements that previously only applied in relation to retail clients. For ECPs, it:

<sup>22</sup> As detailed in CP 16/19, paragraphs 1.17 to 1.23, Article 3 firms are exempt from the need for authorisation as MiFID investment firms, but will need to comply with some requirements in our Handbook that are ‘at least analogous’ to those applying to MiFID investment firms.

<sup>23</sup> See MiFID II recital 104.

- requires information disclosure in more circumstances than currently, by effectively reducing the circumstances in which the conduct of business requirements can be dis-applied, as outlined in Article 30(1)
  - applies the information requirements in Article 24(4) and (5) and the reporting obligations in Article 25(6)
  - creates a two-fold obligation on investment firms, in their relationship with ECPs, to act honestly, fairly and professionally and communicate in a way that is fair, clear and not misleading, as detailed in Article 30(1), second paragraph
- 5.7** In this chapter we propose new rules on how firms doing MiFID business must disclose information to professional clients and ECPs.
- 5.8** In line with MiFID II,<sup>24</sup> ‘clients’ includes retail clients, professional clients and ECPs. For non-MiFID business, unless the firm is an Article 3 firm,<sup>25</sup> we are not proposing to alter how the existing rules apply in relation to professional clients and ECPs.
- 5.9** To implement MiFID II, we introduce or refer to some new requirements in the directly applicable MiFID II delegated regulation. These are disclosure requirements that apply in relation to:
- cross-selling/bundled products or services
  - some more detailed post-sale reporting requirements
  - a revised requirement to retain records for at least five years
- 5.10** In this chapter, the conduct rules on the list of analogous requirements that we propose to apply to Article 3 firms are those detailed in MiFID II Article 24(3), (4) and (5), and Article 25(6).
- 5.11** Unless the firm is an Article 3 firm carrying on MiFID-scope business, we do not propose to apply the effect of the new or revised MiFID II requirements to firms doing non-MiFID business. However, existing domestic requirements regarding treating customers fairly, post-sale reporting<sup>26</sup> and record-keeping will continue to apply to firms doing non-MiFID business.
- Existing provisions**
- 5.12** Our disclosure rules currently require firms to:
- produce ‘fair, clear and not misleading information’
  - produce information in a comprehensible format (which may be standardised)
  - provide general and specific information about the investment firm, its services financial instruments, proposed investment strategies and execution venues

<sup>24</sup> See MiFID II Recital 103.

<sup>25</sup> An Article 3 firm is a firm that is not a ‘MiFID investment firm’; it will only be carrying on a more limited range and type of MiFID-related business, see the conditions in MiFID II Article 3 which we expect will be transposed into domestic law by Article 4(8) of the MiFID Regulations. Typically, such firms will be independent financial advisers that do not hold clients assets, corporate finance firms or venture capital firms.

<sup>26</sup> In relation to the provision of periodic statements by non-MiFID firms, in line with the MiFID provisions, we are proposing exemptions to allow a firm to avoid the need to provide periodic client statements, if they provide clients with access to an online system containing their statements and the firm has evidence that the client has accessed this online statement at least once during the previous quarter.

- provide general and specific information on all costs and associated charges, including timing and on-going disclosure requirements
- provide information about safeguarding designated investments belonging to clients and client money
- provide post-sale and periodic reports, and keep records to show reports have been sent

**5.13** The current disclosure provisions apply differently depending on who receives the information, and whether or not the disclosure requirement relates to MiFID business. Currently, only a few disclosure rules apply in relation to ECPs. More rules apply in relation to professional clients, and most rules are relevant in relation to retail clients. MiFID II changes this.

**5.14** When considering the MiFID II disclosure provisions, following a cost benefit analysis, and pending finalisation of the IDD implementing measures, we sought to avoid applying these provisions in full to firms carrying on non-MiFID business. So, given our current proposals, firms carrying on non-MiFID business should not be subject to significantly different requirements to those that currently apply. However, where the MiFID II provisions are identical to, very similar to, or can be inferred from, existing requirements, we propose to amend rules relevant to non-MiFID business so they are consistent with the provisions that apply to firms carrying on MiFID business.

### **Proposals**

**5.15** In this chapter we propose to:

- Implement in our rules, and reference, the MiFID II provisions in Articles 24(3), 24(4) first and last paragraphs, 24(4)(b) and (c), 24(5), 24(6), 24(11), 25(6) and 30(1) second paragraph.
- Copy out into the Handbook the MiFID II delegated regulation provisions, in Articles 44, and 46 to 51, on providing information to clients and potential clients, the provisions in Articles 59 to 63 on reporting obligations to clients, and recital 73. Although these legislative provisions are directly applicable to MiFID investment firms, in order to provide a coherent text, they will be copied out in the Handbook.
- Introduce rules, derived from MiFID II Articles 24(3), 24(4) first and last paragraphs, 24(4)(b) and (c), 24(5), and 25(6), that will apply to Article 3 firms.
- Amend the application provisions to make it clear which chapter, or section of chapters, applies in relation to MiFID business, or non-MiFID business.

### **Information to clients and potential clients**

**5.16** To implement MiFID II requirements for the provision of information to clients and potential clients, we propose to amend provisions in COBS as described below (the MiFID II delegated regulation provisions are shown in brackets).

#### **Fair, clear and not misleading information requirements (Article 44) MiFID business**

**5.17** To give effect to MiFID II Article 24(3) and Article 30(1), second paragraph, COBS 1 and COBS 4 will be amended to refer to the MiFID II provisions.

**5.18** For firms doing MiFID business, we propose to introduce a revised COBS 4.2.1R to require that firms must communicate with ECPs in a way that is fair, clear and not misleading, taking account of the nature of the eligible counterparty and its business. In relation to these MiFID

investment firms' communications, we propose to introduce a new COBS 4.5A, to reference the MiFID II delegated regulation Article 44(1) to (8) requirements applying when firms communicate with clients.

### **Non-MiFID business**

- 5.19** For firms doing non-MiFID business, including Article 3 firms, we do not propose to impose a requirement that these firms communicate with ECPs in a way that is fair, clear and not misleading, taking account of the nature of the ECP and its business. The existing requirement in the Principles will continue to apply.<sup>27</sup>
- 5.20** The requirement in the MiFID II delegated regulation Article 44(8), that a firm should not imply that we endorse or approve the products or services of the firm, is currently detailed in GEN 1.2 (Referring to approval by the appropriate regulator). We propose to amend GEN 1.2 so that it only applies in relation to non-MiFID business.
- 5.21** For firms doing non-MiFID business, we propose to amend rules in COBS 4.5 and 4.6, to reflect the MiFID II delegated regulation Article 44(2) to (7).
- 5.22** The conditions with which firms must comply in order to be fair, clear and not misleading, and the past and future performance rules, will be amended to align with the text in the MiFID II, maintaining broadly the same effect as the current provisions. We propose to update: COBS 4.5.2R (General rule), COBS 4.5.6R (Comparative information), COBS 4.5.7R (Referring to tax), COBS 4.6.2R (Past performance), COBS 4.6.6R (Simulated past performance) and COBS 4.6.7R (Future performance).
- 5.23** We propose to introduce some extra detail in the updated rules. For example, a new, specific requirement regarding the font size to use when prominently indicating relevant risks, a need for information to be consistently presented in the same language, and a need for information to be up-to-date and relevant to the means of communication used. However, we consider that any requirements described in the amended text can already be inferred from the existing provisions and should not, as such, constitute substantively new requirements for firms in relation to their non-MiFID business.

**Q18: Do you agree with our approach to implementing the MiFID II requirements that relate to providing information to clients?**

**Q19: Do you agree with the decision not to extend the 'fair clear and not misleading' information requirements to firms communicating with an eligible counterparty in relation to non-MiFID business? If not, and you think that we should extend the fair, clear and not misleading information requirements to non-MiFID eligible counterparty business, please provide evidence to support your view.**

- 5.24** **General requirements for information to clients, and financial promotions (Article 46)**  
To implement Article 24(4), first paragraph and (b); and to reflect the related MiFID II delegated regulation Articles 46 and 47, we propose amendments to COBS 2, 4, 6 and 14, and the creation of a new COBS 2.2A, COBS 6.1-A and COBS 14.3A.

<sup>27</sup> See Principle 7: Communications with clients.



**Timing of provision of appropriate information**

- 5.25** For firms carrying on MiFID business, to implement the requirement that firms provide appropriate information ‘in good time’ and refer to ‘all costs and related charges’, (see first paragraph of Article 24(4)), we propose a new COBS 2.2A (Information disclosure before providing services (MiFID related provisions)). This will apply in relation to communications to all clients (including ECPs). This section will also take account of a firm’s right, as detailed in MiFID II delegated regulation Article 50(1),<sup>28</sup> to agree to a limited application of the requirements applying to the disclosure of costs and charges to professional client and ECPs.
- 5.26** We propose that COBS 2.2A will require the disclosure of appropriate information, in good time, to clients with regard to the investment firm and its services, the financial instruments and proposed investment strategies, execution venues and all costs and related charges. The information will include appropriate guidance on and warnings of the risks associated with investments in those instruments or in respect of particular strategies. It will also include information on whether the financial instrument is intended for retail or professional clients, taking account of the identified target market of end clients. Further, proposed rules in COBS 2.2A will detail how firms must provide information to clients on all costs and charges.
- 5.27** For firms doing MiFID business, to reflect the disclosures required by MiFID II delegated regulation Articles 46(1) to (4), we propose new provisions in COBS 14.3A (Information about financial instruments (MiFID related provisions)).
- 5.28** For firms doing non-MiFID business, we propose to update the rules in COBS 6 (Information about the firm, its services and remuneration) and COBS 14 (Providing product information to clients). We propose to update: COBS 6.1.4R and COBS 6.1.6R (Information about a firm and its services), COBS 6.1.11R (Timing of disclosure), COBS 6.1.13R (Medium of disclosure), COBS 6.1.14R (Keeping the client up to date), COBS 14.3.8R (Product information: form), COBS 14.3.9R (The timing rules) and COBS 14.3.10R (Keeping the client up-to-date) so they only apply in relation to non-MiFID business, and when firms communicate with retail clients.

**Consistency**

- 5.29** For firms doing MiFID business, we copy out the MiFID II delegated regulation Article 46(5) in COBS 4.5A.11 EU, which will apply in relation to communications to both clients and ECPs.
- 5.30** For firms doing non-MiFID business, we propose to reflect MiFID II delegated regulation Article 46(5) and update COBS 4.5.8R (Consistent financial promotions) so it remains clear that firms doing this type of business must ensure information in financial promotions is consistent with any other information provided in the course of carrying on designated investment business.

**Direct offer financial promotions**

- 5.31** For firms doing MiFID business, we reflect the requirements in MiFID II delegated regulation Article 46(6) by amending COBS 4.7.1R. The effect of these changes is to ensure that the information required by MiFID II delegated regulation Articles 47 to 50, as relevant, is included in direct offer financial promotions when received by all types of client.
- 5.32** For firms doing non-MiFID business, the proposed changes to COBS 4.7.1R are not intended to alter the current position where specific disclosure requirements will only apply in relation to direct offer financial promotions received by retail clients.

<sup>28</sup> Copied out in COBS 6.1-A.2.8 EU



**Information about the investment firm and its services for clients (Article 47)*****Detailed disclosure about the firm and its services***

- 5.33** For firms doing MiFID business, we propose to implement MiFID II Article 24(4) and Article 30(1), first paragraph, and reflect the related detailed requirements in MiFID II delegated regulation Article 47(1) to (3) by creating a new chapter, COBS 6.1-A. Provisions in this new chapter will reproduce the applicable provisions in the MiFID II delegated regulation. MiFID II delegated regulation Article 47(1) lists the general information that must be disclosed to all clients, where relevant. MiFID II delegated regulation Article 47(2) and (3) lists the additional information that must be given when firms provide portfolio management services. As firms do not provide portfolio management services to ECPs, the portfolio management services requirements will only apply in relation to retail and professional clients.
- 5.34** Detailed information about the firm and its services is currently required by the existing COBS 6.1.4R and COBS 6.1.6R. We propose to amend the application of the relevant provisions in COBS 6.1, so they only apply to firms in relation to non-MiFID business.

**Information about financial instruments (Article 48)**

- 5.35** For firms carrying on MiFID business, we propose to implement MiFID II Article 24(4)(b) and Article 30(1), first paragraph, and reflect the related detailed requirements in MiFID II delegated regulation Article 48, by introducing new COBS 14.3A provisions that reproduce the applicable provisions in the MiFID II delegated regulation.
- 5.36** The disclosure requirements set out in MiFID II delegated regulation Article 48, and reproduced in COBS 14.3A list the information firms must give about the specific investment, including details of the nature of the investment and its associated risks. In COBS 14.3A, we propose to introduce guidance<sup>29</sup> to reflect MiFID II delegated regulation Recital 69 so it is clear that where firms are required to provide information to a client before the provision of a service, each transaction in respect of the same type of financial instrument need not be considered as the provision of a new or different service.
- 5.37** Our rules<sup>30</sup> currently require firms to provide clients with a description of the nature and risks of designated investments. We propose to amend the application of these rules, to ensure they apply only in relation to non-MiFID business.

**Information about safeguarding client instruments and funds (Article 49)**

- 5.38** For firms doing MiFID business, we propose to give effect to MiFID II Article 24(4) and reflect the related detailed requirements, in Article 49 of the MiFID II delegated regulation, that firms provide clients with information about safeguarding of client financial instruments or client funds, by referring to Article 49 in COBS 6.1-A.2.6 EU.
- 5.39** For firms doing non-MiFID business, we propose to amend the application of the existing safeguarding disclosure rule, COBS 6.1.7R, so it applies to firms when they hold financial instruments or clients funds for retail clients, in relation to non-MiFID business.

**Information on costs and associated charges (Article 50)**

- 5.40** For firms doing MiFID business, we propose to implement MiFID II Article 24(4) (c) and second paragraph, to reflect the related detailed requirements in Article 50 of the MiFID II delegated

<sup>29</sup> COBS 14.3A.6G.

<sup>30</sup> See the change being made to COBS 14.3.1R(1) and see also COBS 14.3.2R to 14.3.5R.

regulation, by introducing new rules in COBS 2.2A, and COBS 6.1-A.2.8 EU. These provisions will apply in relation to all clients. In relation to firms providing investment services to professional clients and ECPs, the application of the rules on costs and associated charges disclosure is limited by Article 50(1) of the MiFID II delegated regulation. Article 50 will enable a firm doing MiFID business to agree with these clients to a limited application of the rules on costs and associated charges disclosure, subject to restrictions.<sup>31</sup>

- 5.41** These new provisions introduce new requirements for firms to provide aggregated and on-going information on all costs and associated charges which go beyond what is currently required. MiFID investment firms and Article 3 firms (carrying on MiFID-scope business) will be required to include certain information about the costs and charges, including the cost of advice, where relevant, the cost of the instrument recommended or marketed, how the client may pay for it, and the cost of third-party payments.
- 5.42** The new provisions require that all costs and charges, including those in connection with the investment service and the financial instrument, which are not caused by the occurrence of underlying market risk, are aggregated. This allows the client to understand the overall cost as well as the cumulative effect on the return of the investment. Where the client requests it, firms must also provide an itemised breakdown of costs.
- 5.43** Further, where applicable, firms will need to provide the aggregated information (and itemised information, if requested) to the client on a regular basis, at least annually, during the lifetime of the investment.
- 5.44** There are significant differences between the current and new MiFID approaches to disclosing costs and charges. For example, we currently require firms to disclose the required information ‘in good time’ before the provision of the investment service or financial instrument, unless otherwise provided for by the rules. The existing rules grant exceptions in relation to transactions concluded by means of certain distance communications or by use of voice telephony. In contrast, the new provisions will require point-of-sale disclosure in good time, without any exceptions applying. Further, the new directly applicable provisions in Article 50(9) require that, where there is an on-going relationship, post-sale disclosure on a regular, at least annual, basis.
- 5.45** For firms doing non-MiFID business, we do not propose to apply the new MiFID requirements. So, the existing rules on the provision of information about costs and charges, and the timing of disclosure,<sup>32</sup> will be retained. The relevant application provision will be amended to clarify that they apply only to these firms, in relation to retail clients.

**Q20: Do you agree with our proposal not to extend the MiFID requirements in relation to costs and charges to non-MiFID business (that is not the business of an Article 3 firm)? Do you think there will be difficulties for firms if they need to comply with different disclosure requirements in relation to costs and charges for their MiFID and non-MiFID business?**

#### **Technical challenges in providing information on costs and associated charges**

- 5.46** In DP15/3 we acknowledged that there were technical challenges relating to the disclosure of the various costs and charges that may apply, and invited firms to identify these and suggest

<sup>31</sup> Firms cannot agree to limit costs and charges disclosure to: a professional client, when investment advice or portfolio management services are provided, or when the financial instrument concerned embed a derivative; or to an ECP when, irrespective of the investment service provided, the financial instruments concerned embed a derivative and the ECP intends to offer them to its clients.

<sup>32</sup> See COBS 6.1.9R and COBS 6.1.11R.

ways we might help address them. The technical challenges, concerns and areas of uncertainty raised by respondents are discussed below.

- 5.47** Regarding the overriding costs and charges requirement: firms questioned whether it would be appropriate to provide the information on an on-going basis and whether the different costs should be aggregated. They also raised concerns about the costs of developing the systems required to facilitate the disclosure. We appreciate the challenges. However, as these overriding requirements are outlined in MiFID, these requirements need to be addressed by firms.
- 5.48** Regarding consistency with requirements in other EU legislation: firms were concerned about the interaction between the MiFID II costs and charges disclosure, the PRIIPs key information document (KID) and UCITS key investor information document (KIID). We recognise the need for consistency between these various disclosures, as they form part of a package of information given to consumers, and will continue to take a consistent approach to interpreting requirements to the extent this is possible. However, firms will need to continue to comply with implemented or directly applicable provisions in EU legislation, as appropriate.
- 5.49** Some firms asked about how forward-looking costs would be disclosed at the point-of-sale (such as transaction costs and performance fees). Although we may provide guidance on this in future, at present, firms will need to comply with implemented or directly applicable provisions in EU legislation, as relevant.
- 5.50** Some firms noted that, for an investment firm to provide some costs and charges information to a consumer, they would need information from other firms in the value chain. We are not in a position to compel every firm in the value to chain to provide this information, particularly if they are not regulated by us (eg a Japanese issuer of securities or US mutual fund). However, we take the view that cost information is usually available for these investments, even if an investment firm may need to undertake some work to include this in the aggregated MiFID disclosure, and require its disclosure from its counterparties. Further, to the extent it is reasonable to do so, a firm will be able to rely on information provided in writing by another person<sup>33</sup> in making its disclosures.
- 5.51** Some firms outlined the need to contextualise the data, outlining the risks of presenting costs in isolation from risks and rewards. In our view, the relevant provisions do not prevent firms from contextualising this data providing they do not disguise, obscure or diminish the information on costs.

### Costs and charges in relation to UCITS and PRIIPs (Article 51)

- 5.52** For firms doing MiFID business, we propose to give effect to MiFID II Article 24(4) and reflect the related detailed requirements of Article 51 of MiFID II delegated regulation by creating a new COBS 14.3A.8EU. This provision will be relevant to firms when distributing units in a UCITS scheme or PRIIPs. It refers to the interaction of the disclosure requirements in the UCITS Directive and the PRIIPs Regulation with those in MiFID II. Such firms will need to provide clients with additional information about other costs and charges related to the product purchase, which may not have been included in the UCITS KIID or PRIIPs KID, including the costs and charges relating to their provision of investment services in relation to that product.

<sup>33</sup> See COBS 2.4.6R(2)

### Comprehensible information (MiFID II Article 24(5))

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- 5.53** For firms doing MiFID business, we propose to give effect to MiFID II Article 24(5) and introduce a new rule in COBS 2.2A.5R, transposing the text of this Article. This rule will apply in relation to all clients.
- 5.54** MiFID II Article 24(5) requires firms to provide information (referred to in Article 24 (4) and (9)) in a comprehensible form and in such a manner that clients are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis.
- 5.55** Article 24(5) also states that we can allow for this information to be presented in a standardised format. In DP15/3, we invited views on whether we should develop a standardised format for disclosing costs and charges to retail clients for both point-of-sale and post-sale disclosures. A number of respondents were in favour of us developing a standardised disclosure as this might provide greater certainty for firms implementing the requirement and potentially help retail clients compare costs between different firms. In contrast, other respondents did not support the development of a standardised disclosure as they felt this could restrict firms' ability to design a disclosure that reflected the services they offer, their distribution model and target clients. Respondents also felt it was important to achieve consistency between the MiFID II disclosure requirements and the KID required by the PRIIPs Regulation.
- 5.56** As outlined earlier in this Chapter, we recognise the importance of consistency across the various disclosures consumers receive, including the MiFID II costs and charges disclosure and PRIIPs KID. However, we do not consider it appropriate to develop a standardised format for firms to disclose their costs and charges at the current time. This is in line with our Smarter Consumer Communications initiative, which gives firms flexibility to develop disclosures that reflect the needs of their target customers and their business proposition.
- 5.57** In the future, we may reconsider whether it would be appropriate to develop a standardised costs and charges template. This could reflect, for example, the disclosure requirements being introduced as part of the IDD for insurance-based investment products. If we were to develop a standardised template, we would test possible approaches with consumers.
- 5.58** For firms doing non-MiFID business, we propose to amend the application of the current rule<sup>34</sup> regarding disclosure of information about the firm, its services and investments, so it only applies to firms carrying on non-MiFID business. So, for example, in relation to an insurance-based product, firms will still be required to disclose to retail clients appropriate information in a comprehensible form and in such a manner that clients are reasonably able to understand the nature and risks of the investment that is being offered and, consequently to take investment decisions on an informed basis.

**Q21: Do you agree with our proposal not to propose a standardised format to point-of-sale and post-sale disclosures? If not please give reasons why.**

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<sup>34</sup> COBS 2.2.1R

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### Cross-selling/Bundled products or services (MiFID II Article 24(11))

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- 5.59** In relation to MiFID business, we propose to give effect to MiFID II Article 24(11) and introduce a new rule in COBS 6.1-A2, which will transpose its requirements and apply in relation to all clients.
- 5.60** MiFID II Article 24(11) introduces a requirement which applies when an investment service is offered together with another service or product as part of a package or as a condition for the same agreement or package. In such cases the firms will be required to inform the client whether it is possible to buy the different components separately and must provide for a separate account of the costs and charges of each component.
- 5.61** Where risks resulting from such an agreement or package offered to a retail client are likely to be different from the risks associated with the components taken separately, the investment firm must provide an adequate description of the different components of the agreement or package and the way in which their interaction modifies the risks.<sup>35</sup>
- 5.62** For firms doing non-MiFID business, we do not propose any rule changes. We consider the effect of these new MiFID requirements to be in line with the high-level requirements which currently apply: to treat customers fairly and provide sufficient information.<sup>36</sup>
- 5.63** ESMA has issued guidelines on cross-selling practices. These guidelines apply from 3 January 2018 – in line with the implementation date of the wider MiFID II package. We have notified ESMA of our intention to comply with these guidelines.

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### Reporting to clients

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- 5.64** To implement MiFID II requirements<sup>37</sup> for the provision of adequate reports to clients on the service provided, we propose to amend provisions in COBS as described below.

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### Periodic Reports

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- 5.65** For firms doing MiFID business, we propose to implement the requirement in MiFID II Article 25(6), first paragraph, for firms to provide clients with adequate reports in a durable medium, by introducing a new rule, COBS 16A.1.2R. This rule requires firms to provide adequate reports that include periodic communications to clients, taking into account the type and complexity of financial instrument involved and the nature of the service provided to the client. This should include, where applicable, the costs associated with the transactions and services undertaken on behalf of the client.
- 5.66** To implement the requirement, in MiFID II Article 24(4) last paragraph, last sentence, we propose to introduce a new rule, COBS 2.2A.3R(3). This requires firms to provide clients with information on cost and charges on a regular basis, at least annually, during the lifetime of the investment.

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<sup>35</sup> See MiFID II recital 81.

<sup>36</sup> See COBS 4.5.2R(3) in relation to the requirement to provide sufficient information.

<sup>37</sup> MiFID II Article 24(4) last paragraph, last sentence, Article 25(6), first paragraph and MiFID II delegated regulation Article 65 to 69 and Article 79.

### Reporting obligations in respect of execution of orders other than for portfolio management (Article 59)

- 5.67** For firms doing MiFID business, we propose to give effect to MiFID II Article 25(6) and reflect the related requirements in Article 59 of the MiFID II delegated regulation by creating a new COBS 16A.2.1 EU. This new provision will detail the content and timing of the essential information that firms, having carried out an order other than for portfolio management, must give clients post-sale.
- 5.68** For firms doing non-MiFID business, or business relating to UCITS schemes or EEA UCITS schemes, the existing rules in COBS 16.2 regarding reporting obligations will apply. So, for example, for non-MiFID business there will be no requirement for firms to send post-sale notices to professional clients.

### Reporting obligations in respect of portfolio management (Article 60)

- 5.69** For firms doing MiFID business, we propose to give effect to MiFID II Article 25(6) and reflect the related requirements in Article 60 of the MiFID II delegated regulation by creating a new COBS 16A.3.1 EU. This new provision details firms' reporting obligations when managing investments.
- 5.70** For firms doing non-MiFID business, we propose to amend the content of COBS 16.3.1R, 16.3.2R and 16.3.3R so the application of the revised rules has the same effect for firms carrying on non-MiFID business as they do now. So, in relation to non-MiFID business, firms will need to provide periodic statements every six months, but not every three months (as is the case with MiFID business), unless the client requests this. In addition, in line with the MiFID II provisions, we are proposing to introduce an exemption to allow a firm doing non-MiFID business to avoid the need to provide such a statement, so long as they provide clients with access to an online system containing their up-to-date statements and the firm has evidence that the client has accessed this online statement at least once during the previous quarter.<sup>38</sup>

### Reporting obligations in respect of eligible counterparties (Article 61)

- 5.71** For firms doing MiFID business, we propose to give effect to MiFID II Article 25(6) and reflect the related requirements in Article 61 of the MiFID II delegated regulation by creating a new COBS 16A.5.1EU. This will clarify that the provisions reflecting Article 49 (COBS 6.1-A EU) and Article 59 (COBS 16A.2.1 EU) apply in respect of ECPs, unless firms enter into agreements with the ECPs to determine the content and timing of reporting (which may be different from the requirements in relation to retail and professional clients).

### Additional reporting obligations for portfolio management or contingent liability transactions (Article 62)

- 5.72** For firms doing MiFID business, we propose to give effect to MiFID II Article 25(6) and reflect the related requirements in Article 62 of the MiFID II delegated regulation by creating a new COBS 16A.3.3 EU. These provisions will require firms to report when a client's managed portfolio, or position in leveraged financial instruments or contingent liability transactions, depreciates by 10%, and thereafter at multiples of 10%. To reflect Recital 96 in the MiFID II delegated regulation, we propose to introduce a rule, COBS 16A.3.4R, to clarify that, for portfolio management, a contingent liability transaction should involve any actual or potential liability for the client that exceeds the cost of acquiring the instrument.

<sup>38</sup> COBS 16.3 applies to a small authorised UK AIFM of an unauthorised AIF which is not a collective investment scheme, as a result of COBS 18.5.2R. We are currently considering how the proposed amendment to COBS 16.3 will apply to such firms and may make further modifications in relation to these firms.

- 5.73** For firms doing non-MiFID business, we propose that the provisions in COBS 16.3.6R will apply as they do currently. So, reports to retail clients will only be needed when losses exceed any pre-determined threshold agreed between the firm and the client.

### Statements of client financial instrument or client funds (Article 63)

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- 5.74** For firms doing MiFID business, we propose to give effect to MiFID II Article 25(6) and reflect the related provisions in Article 63 of the MiFID II delegated regulation by creating a new COBS 16A.4.1 EU. These provisions will require firms to satisfy disclosure requirements detailed in Article 63(2)(d) to (f) and give clients statements that contain more information about the assets held than is currently required.
- 5.75** For firms doing non-MiFID business, we propose that the rules in COBS 16.4 will continue to apply. These cover the timing and content of statements of client designated investments or client funds that must be provided. In addition, in line with the MiFID II provisions, we are proposing to introduce an exemption to allow a firm doing non-MiFID business to avoid the need to provide such a statement, so long as they provide clients with access to an online system containing their up-to-date statements and the firm has evidence that the client has accessed this online statement at least once during the previous quarter.

**Q22: Do you agree with our proposals to amend COBS 16.3 and 16.4 to allow firms doing non-MiFID business to avoid the need to provide their clients with periodic statements, so long as clients have accessed their statements via an on-line system which qualifies as a durable medium? If not please give reasons why.**

### Retention of records to show reports sent (Article 72)

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- 5.76** For firms doing MiFID business, we propose to give effect to MiFID II Article 16(6) and reflect Article 72 of the MiFID II delegated regulation, in new provisions in SYSC 9. We will refer to these record-keeping provisions in COBS 16A.6.1G. The new record-keeping requirements are more detailed; they require firms doing MiFID business to keep records for a period of five years and, where requested by the FCA, for a period of up to seven years.
- 5.77** For firms doing non-MiFID business, we propose that the record-keeping requirements in COBS 16.2.7R and COBS 16.3.11R which require firms to retain records for three years will continue to apply.

### Implications for firms

- 5.78** The new disclosure requirements are primarily applicable to firms doing MiFID business. Firms undertaking non-MiFID business may also be affected in minor ways.
- 5.79** Firms doing MiFID business will be subject to more detailed requirements, when communicating with professional clients, in line with those currently applying when communicating to retail clients. These firms will need to amend their disclosures accordingly. Firms will also need to amend their approach to communicating disclosures to ECPs, to comply with the additional requirements that will apply.



**Implications for consumers**

**5.80** Retail clients will notice little difference following the application of these revised rules. However, professional clients and ECPs will notice changes to the quantity and detail of the disclosure material they receive. We consider that these changes should improve both market integrity and transparency.

**5.81** The changes proposed will potentially benefit those professional clients who are less likely to have in-house expertise or the resources to fully appreciate the risks involved with investing in complex products.

**Discussion**

**5.82** Regarding the limited extension of the MiFID II rules to non-MiFID business, in some areas we consider that the same risks tend to apply in the provision of designated investment business, whether for MiFID or non-MiFID business. For example, investment losses can occur just as easily through the provision of an insurance-based investment product (non-MiFID) as with a transferable security (MiFID). Alleged mis-selling has occurred in relation to both MiFID and non-MiFID products, and has even extended to simpler products such as fixed-term deposits.

**5.83** However, in most areas we are not convinced of the need to extend the MiFID approach beyond the scope of MiFID. So, unless the new MiFID provisions have broadly the same effect as existing non-MiFID provisions, we are not applying them more widely.

**References**

**5.84** Existing provisions are set out at: GEN 1.2, COBS 1.1.2R and COBS 1, Annex 1, Part 1, COBS 2.2.1R, COBS 4.2, 4.5 and 4.6, COBS 6.1.7R, 6.1.8R, 6.1.9R, 6.1.11R, 6.1.18R, COBS 16.2.

**5.85** The new requirements are:

- Recitals 72, 103 and 104, Articles 16(6), 24(3), 24(4), 24(5), 24(6), 24(11), 25(6), 30(1), Annex II (1) (3) and Annex II (2), paragraph 1, 3, 5 & 6, of MiFID II.
- Recitals 69 and 96, Articles 44, 46 – 51, 59-63, 72, 78, and Annex I of the MiFID II delegated regulation.



## 6. Independence

### Who should read this chapter

Firms conducting MiFID or equivalent third country business and firms conducting non-MiFID business (including Article 3 firms) which provide personal recommendations to either retail or professional clients.

Consumers and consumer organisations.

### Introduction

- 6.1** While the concept of independent advice has been a feature of the UK advice market for many years, MiFID II introduces a European-wide standard for ‘independent advice’ for the first time. This sets out that firms describing their advice as independent must assess a sufficient range of financial instruments. The instruments must be sufficiently diverse in terms of their type and issuers or product providers to ensure they suitably meet the client’s objectives, and not be limited to investments issued or provided by closely linked entities. In DP15/3 we explored the MiFID II requirements against our existing independence standard and asked for feedback on the most appropriate way to incorporate the requirements into our Conduct of Business sourcebook.
- 6.2** In this chapter we provide an overview of the feedback we received and set out our Handbook proposals in this area. In contrast to some other sections of this CP, we address the non-MiFID policy issues here, rather than waiting for further clarification of the requirements under the IDD (see the general discussion of this issue in the Overview). This is because independent advisers may look across both MiFID and non-MiFID products when making personal recommendations and so we believe for this issue in particular it is preferable to take a cohesive approach.

### Existing Provisions

- 6.3** The RDR introduced the UK’s current definition of independent advice at the end of 2012. The aim was to ensure that independent advice was genuinely free from bias towards particular products or any restrictions that would limit the range of solutions that firms could recommend to their clients. This means that when providing independent advice, a firm should not be restricted by product provider and should be able to objectively consider all types of RIPs which can meet the investment needs and objectives of a retail client.
- 6.4** The current UK independence standard applies to firms making personal recommendations to retail clients in the UK on RIPs. In DP15/3 we explained how RIPs include investment products both in scope of MiFID II (structured products and UCITS), and some products outside scope (insurance-based investments and personal pensions).

### Proposals

- 6.5** We propose to implement the MiFID II independence standard for personal recommendations to retail clients in the UK for both MiFID financial instruments and structured deposits and for non-MiFID RIPs (such as insurance-based investments and personal pensions). For professional clients and, where relevant, retail clients outside the UK (who are currently not covered by the RDR independence standard), we propose to apply only what is required by MiFID II. This is the MiFID independence standard on financial instruments and structured deposits only.
- 6.6** We are also proposing to include guidance to clarify our expectations of what the MiFID standard means to help firms demonstrate that they are meeting the standard and ensure firms interpret it consistently. For example, we propose guidance confirming that since the assessment conducted by an independent firm must ensure that the client's objectives can be suitably met, a firm providing independent advice should be in a position to advise on all product types within the scope of the market on which it provides advice. It will not, however, be necessary for firms to assess every single product available on the market. A firm not specialising in a particular market would generally be expected to be in a position to consider all financial instruments, structured deposits and other non-MiFID RIPs which would be capable of meeting the investment objectives of its retail clients.
- 6.7** Finally, for advice that falls outside the scope of MiFID II, with certain limited exceptions, we propose to apply as rules the provisions of the MiFID II delegated regulation. This will be relevant to, amongst others, non-MiFID (including Article 3) firms and MiFID firms providing advice to retail clients on RIPs which are not financial instruments. We propose to apply the provisions of the MiFID II delegated regulation in this way where:
- we consider that they are needed to clarify or substantiate the requirements of the independence standard in MiFID II which we are adopting, or
  - are otherwise consistent with our current rules and guidance.

### Implications for firms

- 6.8** We do not expect there to be any widespread, significant implications for firms arising from the implementation of MiFID II's independence standard. However, we consider that this may allow some 'independent' advisory firms to narrow the scope of advice they offer more often and provide more specialist or specific advice (provided this is made clear to consumers).
- 6.9** Also, some firms which provide both independent and non-independent or 'restricted' advice (on MiFID financial instruments) need to consider any changes they should make to comply with MiFID's organisational requirements. This is particularly the case in relation to MiFID's prohibition on individual advisers providing both independent and non-independent advice.

### Implications for consumers

- 6.10** We do not expect there to be any material differences in the protections afforded to consumers. This is because the new regime is similar to our existing domestic rules and guidance.

### Discussion

- 6.11** As explained above, MiFID II introduces a standard for independent advice which requires firms to assess a sufficient range of financial instruments. These instruments must be sufficiently diverse in their type and issuers or product providers, to ensure the client's objectives can be suitably met.
- 6.12** Under the UK's RDR standard, to be considered 'independent', firms' recommendations to retail clients in the UK must be based on a comprehensive and fair analysis of the 'relevant

market'. To meet this standard we generally expect independent firms to consider *all* RIPs that can meet the investment needs and objectives of a retail client. The Glossary defines those products which constitute RIPs.<sup>39</sup>

**6.13** In DP15/3 we asked:

- Q13.. 'Do you consider that MiFID II's standard of independent advice is different, in practice, to the UK's RDR standard?'

**6.14** Responses were mixed. Some respondents felt there was a difference, with the UK standard being more onerous. Others believed that the two standards would lead to similar outcomes. Overall, a majority felt that the MiFID II standard was preferable. Respondents considered that the current RDR definition was difficult to achieve in practice because it was not practicable to consider all types of products that may be suitable for a particular retail client. Therefore the MiFID independence standard was regarded by many respondents as more realistic or closer to the common meaning of independent than the RDR standard. Some respondents also believed that the MiFID standard was more closely linked to consumers' understanding of independence – ie being 'independent of influence' – rather than reflecting the extent of the range of products/providers considered by an adviser.

**6.15** However, some felt that another change to independence should be avoided and so recommended maintaining the RDR definition. A few respondents thought that the MiFID standard of 'sufficient' range of products and providers would need guidance to help firms understand their obligations. A number of stakeholders called for a consistent approach and felt that it could be confusing to have different definitions of independence for different types of investments (for example between RIPs and shares, bonds etc.).

**6.16** The current UK independence requirements apply to advice on RIPs, which include some products outside of the scope of MiFID (eg pensions and insurance-based investments). The MiFID II independence requirements also apply to advice on shares, bonds, derivatives and structured deposits – which are all currently outside of the scope of our RIP definition (and hence outside of our current independence rules). Therefore in the DP we asked:

- Q14.. 'How should we implement MiFID II's requirement to develop an independence standard for advice on shares, bonds and derivatives?..'

**6.17** There was some agreement that it would not be proportionate to include shares, bonds and derivatives within the RDR definition of independence. This was due to the burden on advisers for example in significant additional search costs, without being clear on the detriment it would mitigate.

**6.18** A number of respondents supported replicating the RDR model and devising a basket of relevant products. Some respondents reiterated the problem of having different standards for different product types and the potential confusion it could cause.

#### ***Policy options considered***

**6.19** We have considered the case for retaining the RDR 'comprehensive and fair' assessment of RIPs for independent advice to retail clients in the UK. However, as highlighted in the earlier

<sup>39</sup> RIPs are (a) a life policy; or (b) a unit; or (c) a stakeholder pension scheme (including a group stakeholder pension scheme); or (d) a personal pension scheme (including a group personal pension scheme); or (e) an interest in an investment trust savings scheme; or (f) a security in an investment trust; or (g) any other designated investment which offers exposure to underlying financial assets, in a packaged form which modifies that exposure when compared with a direct holding in the financial asset; or (h) a structured capital-at-risk product; whether or not any of (a) to (h) are held within an ISA or a CTF.

Discussion Paper, for shares, bonds and derivatives we do not believe that adding them to our definition of RIPs and requiring a ‘comprehensive and fair’ assessment (ie the current UK standard) would be proportionate.

- 6.20** So we have also considered whether alternatively, it would make sense to have two different standards in place. These would be both the RDR’s standard for independent investment advice on RIPs to retail clients; and the MiFID II standard for independent advice on shares, bonds, derivatives, and for advice on all MiFID investment products to professional clients. This alternative solution would specify two, near identical standards for independence in COBS, one for MiFID products and one for non-MiFID products. Our view is this would be likely to add complexity and confusion for consumers and create significant uncertainty for no clear benefit, particularly given the extent of the similarity between the standards.

#### ***Comparison of RDR and MiFID II standards***

- 6.21** Following the publication of the MiFID II delegated regulation, our view is that the MiFID II and RDR independence standards are broadly consistent in terms of overall approach, regulatory objective and intended outcome. We explain our reasons for this below.

- 6.22** The two limbs of the RDR standard are that, in order to hold itself out as independent, a firm’s personal recommendations must be:

- based on a comprehensive and fair analysis of the relevant market
- unbiased and unrestricted

#### ***Comprehensive and fair analysis***

- 6.23** The MiFID II Directive sets out that an investment firm providing independent advice will have to ‘*assess a sufficient range of financial instruments available on the market which must be sufficiently diverse with regard to their type and issuers or product providers to ensure that the client’s investment objectives can be suitably met*’. Before an adviser has had an initial discussion with a client, the firm does not know what that client’s objectives, needs or circumstances might be. A firm that offers independent advice would need to be able to advise on all product types (which would come within the firm’s service offering) because it is only once the particular client’s needs are set out that the firm can decide which range of product types is likely to be ‘sufficient’ to suitably meet the client’s objectives.

- 6.24** The MiFID II delegated regulation goes on to require that ‘the criteria for selecting the various financial instruments shall include all relevant aspects such as risks, costs and complexity as well as the characteristics of the investment firm’s clients’. In its technical advice to the European Commission, ESMA noted that this was intended to prevent firms unduly excluding certain product types from the selection process, perhaps because they were less costly or complex. It considered that this ‘would not be in line with the overarching principle to act honestly, fairly and professionally in accordance with the best interests of clients’.

- 6.25** We consider that the MiFID and RDR standards arrive at a similar place but from slightly different starting points. In practice, under both standards firms make a recommendation after a broad assessment of potentially suitable products, where product types which may best meet the client’s objectives have not been unduly dismissed without consideration. Evidence from our CBA questionnaire supports the view that there would not be a significant change in the range of products considered by advisers under the MiFID standard. Our survey found that around 75 per cent of independent advisers said they would not decrease the range of products that they currently consider if the MiFID standard applied. For those who said that they might no longer consider certain products, these tended to be higher risk ‘niche’ products such as UCIS, hedge funds or other products not regulated by us.

***Unbiased and unrestricted***

- 6.26** MiFID II sets out that the sufficient range of financial instruments must not be limited to financial instruments provided by the investment firm itself or by other entities with which the firm has close links, such as a contractual relationship. This means that firms will not be able to only recommend their own products and still call themselves independent. The MiFID II delegated regulation also requires the firm to ensure that the selection of the instruments that may be recommended is not biased and that the quantity of financial instruments issued by the investment firm itself or by entities closely linked to it are proportionate to the total amount of financial instruments considered.
- 6.27** We believe our approach to implementing the MiFID standard will achieve a similar outcome and level of consumer protection in respect of both limbs of our current standard. We therefore propose to apply the MiFID II standard to MiFID financial instruments, structured deposits and other non-MiFID RIPS for UK retail clients. This is to ensure consistent regulatory standards, a competitive, level playing field and to prevent potential consumer confusion.

**Q23: Do you agree with our analysis of the two (MiFID II and RDR) independence standards? If not, please give reasons why.**

**Q24: Do you agree with our proposal to apply the MiFID standard of independence to financial instruments, structured deposits and other non-MiFID RIPS for UK retail clients? If not, please give reasons why.**

***How firms describe themselves***

- 6.28** In the DP we explained how a possible implication of the MiFID II standard is that it would allow 'independent' advisers greater scope than the RDR to describe themselves in different ways according to the categories or range of products on which they provide advice. We do not, however, expect that firms will often hold themselves out, or define the scope of advice in a very narrow way, as this could restrict their potential client base. As described above in paragraph 6.25, the majority of firms in our survey stated that they would not decrease the range of products that they currently consider if the MiFID standard applied.
- 6.29** A firm providing independent advice to retail clients which is narrower in scope than all RIPS, financial instruments and structured deposits may include the word 'independent' in its name as long as its marketing materials are sufficiently clear as to the nature of the service provided by the firm. For example, a firm which provides advice only on pensions might describe itself as providing independent advice eg Evans Independent Pensions Advisers. It would however need to ensure that any marketing materials explained that the firm only provided advice on pensions. The firm would need to ensure that it was in a position to advise on all pension product types within its service offering and, once providing advice to a particular retail client, would need to consider a sufficient range of pension products which were sufficiently diverse, in terms of their type and provider, to suitably meet the client's objectives.

***Structured deposits***

- 6.30** In the DP we explained that MiFID II requires Member States to include provision for independent advice on structured deposits. We asked for stakeholder views on how best we should incorporate them into the Independence regime. We asked:
- 'Q16: Should we include structured deposits within our definition of 'retail investment product'?''

**6.31** The majority of respondents agreed that we should include structured deposits within our definition of RIPs due to their substitutability with some retail investment products. However, we do not propose we amend the Glossary definition of RIP, because this would also make structured deposits subject to the adviser charging rules (as noted in chapter 2). Instead, the overarching independence rule includes structured deposits (as well as RIPs and MiFID financial instruments) in order to give effect to MiFID's obligations in this area.

#### ***Insurance based investments***

**6.32** In the DP we also explored the related issue of whether we should retain insurance based investments and pension products in our definition of RIPs and asked:

- '...Q15: Should we continue to include insurance based investments and pensions within our definition of 'retail investment product'?'

**6.33** The vast majority of respondents agreed that insurance based investments and pensions should continue to be included within our definition of RIPs. Where respondents gave a reason, it was generally to ensure consistency between substitutable products. There were a few notable responses which disagreed, primarily because they believed we should move to a MiFID standard across the board and dispense with the concept of RIP. We intend to keep the concept of RIPs to facilitate the application of the independence standard to advice on non-MiFID products.

#### ***MiFID II delegated regulation***

**6.34** There are a number of detailed requirements within the MiFID II delegated regulation on independence which, in the main, clarify or substantiate the requirements of the MiFID II standard and/or reflect current rules and guidance. We propose to apply most of those requirements as rules to advice falling outside of the scope of MiFID II. In summary, the main requirements are:

- **Information requirements** – Explaining how the service satisfies the conditions for the provision of independent advice and the factors the firm has taken into account in recommending a financial instrument.
- **Product selection process** – To be independent, a firm's selection process will need to ensure that the number and variety of products recommended is proportionate to the scope of advice offered and adequately representative of financial products available on the market. Similarly, firms must ensure that the number of the firm's own products, or from providers closely linked to the firm, is proportionate to the total amount of financial instruments considered. Finally firms should include consideration of all relevant aspects (such as risks, costs, complexity, and client characteristics) and ensure that the selection of the instruments is not biased.
- **Clarity of service (independent/non-independent advice)** – Where an investment firm offers or provides advice to the same client on both an independent and restricted basis, it must explain the scope of both services to allow investors to understand the differences between them and not present itself as independent for the overall activity.
- **Specialist independent advice** – MiFID II has requirements for investment firms providing independent investment advice that focus on certain categories or a specified range of financial instruments, for example 'ethical' advisers. A firm specialising in this way should market itself in a way that is intended only to attract clients with a preference for those categories or ranges of financial instruments.

**Further requirements in the MiFID II delegated regulation**

- 6.35** There are a small number of elements which represent new, additional obligations on firms which, in our view, do not appear to generate sufficient benefits to consumers to merit being extended to advice on non-MiFID products.
- 6.36** Article 53 (3) of the MiFID II delegated regulation sets out certain organisational requirements which must be complied with when a firm offers both independent and non-independent (restricted) advice. In particular, it stipulates that an individual adviser may not provide both independent and non-independent advice. The MiFID II delegated regulation explains that this is intended to reduce potential consumer confusion about the type of advice they are receiving.
- 6.37** Under our current rules an individual adviser may switch from independent to non-independent advice provided that they make clear to the client the nature of the advice they are providing, and do not hold themselves out as independent for their advice overall. Our view is that it should be possible for advisers to ensure that the client is aware of the type of advice being provided.
- 6.38** We recognise that these requirements are likely to be of particular difficulty for some firms, especially for adviser firms with only one adviser. However, analysis of our Retail Mediation Activities Return data has shown that the number of firms who provide both types of advice is currently small (just over 2.5% of financial adviser firms offer both types of advice). By not reading across this restriction to advice which falls outside of MiFID II, this will allow advisers who do not advise on MiFID FIs or structured deposits to continue to provide both independent and restricted advice.

**Q25: Do you agree with our approach to implementing MiFID II's requirements around providing both independent and non-independent (restricted) advice? If not, please give reasons why.**

- 6.39** Article 52 (2) of the MiFID II delegated regulation requires that firms which recommend their own products (or those provided by entities with close links as well as others) must distinguish the range of products provided by entities who do not have any links with them. This means that firms would need to highlight to consumers the range of products they have no connection with.
- 6.40** On one hand this may appear to potentially support competition. However, it places the onus on clients to act on the information they have been given. From our knowledge of consumer behaviour, it is not clear that they are equipped to do so, and they are likely to simply follow the adviser's recommendation. We consider it may be a more powerful regulatory tool to place the onus on firms, which MiFID does in a separate requirement we are reading across and which reflects our current approach. This ensures that firms are not recommending a disproportionate amount of their own or closely linked products. Therefore we do not propose to read the obligation (to distinguish the range of products provided by entities with no links) across to non – MiFID products.
- 6.41** Finally, a further element (contained within Article 52 (1) of the MiFID II delegated regulation) which we propose not to extend across to advice on non-MiFID products is a restriction on giving undue prominence to the firm's independent investment advice services over non-independent advice services in their communications with clients. Our view is that it is not clear what specific consumer detriment this is intended to guard against given any communications must be fair, clear and not misleading.



**Q26: Do you agree with our approach to reading across these further requirements from the MiFID II delegated regulation? If not, please give reasons why.**

***Territorial scope***

- 6.42** We propose that the application of the independence regime to advice on non-MiFID RIPs should only apply when advising a retail client in the UK (in accordance with the current territorial application of COBS 6.2A). This means, for example, that when a UK investment firm provides ‘independent’ investment advice to a retail client in France on the basis of a cross-border services passport, it would only be required to have regard to a sufficient range of MiFID financial instruments and structured deposits.

***References***

- 6.43** Our current rules on independence are in COBS 6.2A. We propose to replace this with a new COBS 6.2B.
- 6.44** The new requirements are in:
- Articles 24(4) and 24 (7), which sets out the overarching independence requirement of MiFID II
  - Articles 52 and 53 of the MiFID II delegated regulation



# 7.

## Suitability

### Who should read this chapter

Firms conducting MiFID or equivalent third country business and Article 3 firms which provide personal recommendations to either retail or professional clients

Consumers and consumer organisations

### Introduction

- 7.1** Suitability requirements are intended to ensure that advisers take certain steps when they provide personal recommendations to clients. These steps include getting information on the client's knowledge and experience in relation to the relevant investment field, their financial situation and investment objectives. This is to enable advisers to make a recommendation, or take a decision, which is suitable for that client.
- 7.2** MiFID II expands on the existing MiFID suitability provisions by adding the following requirements:
- To assess the suitability of the overall package where advice is provided on a package of bundled products or services (see the second paragraph of Article 25(2) of MiFID II).
  - Where advice or a discretionary management service is provided wholly or partly through an automated or part-automated system, the firm remains responsible for the suitability assessment. Its responsibility is not reduced by use of the automated system to make personal recommendations or decisions to trade (see the second paragraph of Article 54(1) of the MiFID II delegated regulation).
  - To ensure that information collected about clients is reliable, including considering whether there are any obvious inaccuracies in the information provided (see Article 55(3) of the MiFID II delegated regulation).
  - To ensure information about a client is kept up-to-date if the firm is providing ongoing advice or discretionary management services (see last paragraph of Article 55(7) of the MiFID II delegated regulation).
  - For periodic suitability reports for discretionary management.
  - That a firm has a policy for deciding who the suitability assessment should relate to, where the client is (a) a legal person; (b) a group of two or more natural persons, or (c) one or more natural persons (a natural person is a human being as opposed to a legal 'body') represented by another natural person (see Article 54(6) of the MiFID II delegated regulation).

- No personal recommendation should be made, or decision to trade be taken, if none of the services or investments are suitable for the client. This was implicit before, but is now a specific requirement in the MiFID II delegated regulation (see Article 54(1)).
- When advice or discretionary management involves switching investments, the firm must collect information on the client's existing investments and the recommended new investments, in order to analyse the costs and benefits of the switch, so that the firm can reasonably demonstrate that the benefits of switching are greater than the costs (see Article 54(11) of the MiFID II delegated regulation).
- Where the firm provides a service which involves periodic suitability assessments and reports, the reports it produces following the initial report can be limited to changes in the services or investments involved, and changes in the client's circumstances.

### Existing provisions

- 7.3** Our current requirements on suitability are set out in COBS 9.
- 7.4** These requirements apply to firms advising on, or managing portfolios in relation to, non-MiFID products (insurance-based investments and pensions) as well as MiFID products.
- 7.5** We propose that the current provisions should remain in place (in the amended COBS 9 in Appendix 1), but apply only to firms advising on, or managing portfolios in relation to, non-MiFID products.
- 7.6** As explained in the Overview, we are not in general proposing changes for these products pending consultation on implementation of the IDD. The existing suitability requirements, as they apply to firms advising on, or managing portfolios in relation to, MiFID products, have been moved into a new COBS 9A in Appendix 1. The new MiFID requirements, which apply to a firm carrying on MiFID or equivalent third country business and to an Article 3 firm carrying on MiFID-scope business are contained in the new COBS 9A.

### Proposals

- 7.7** The new MiFID II requirements are mostly set out in the MiFID II delegated regulation, with the exception of that on bundled products and services where the relevant rules are set out in MiFID II. We do not have any discretion to apply requirements which are additional to those in MiFID II and the delegated regulation.
- 7.8** We have copied out relevant sections of the MiFID II delegated regulation into the new draft of COBS 9A. We have also transposed relevant sections of MiFID II. Where we apply provisions of the copied out delegated regulation as rules to firms in respect of non-MiFID business, we have 'translated' some words and phrases used into Glossary terms. A table sets out the directive terms and equivalent Handbook Glossary definitions.
- 7.9** MiFID II Article 3.2(b) requires us to have suitability requirements for Article 3 firms which are 'at least analogous' to those for other firms, and we propose to apply the provisions in the new COBS 9A to them in full.

**Q27: Do you have any comments on our proposal to keep the current rules for non-MiFID products pending implementation of the IDD? If not, please give reasons why.**

**Q28: Do you have any comments on the new COBS 9A in Appendix 1?**

**Q29: Do you agree that the new COBS 9A should apply in full to Article 3 firms? If not, please give reasons why.**

**Implications for firms**

**7.10** The new MiFID requirements include more specific requirements than before to ensure suitability of personal recommendations, such as the requirement to ensure information about the client is up-to-date if the firm is providing ongoing advice or a discretionary management service. Firms must make any changes necessary to allow them to comply with the additional obligations.

**Implications for consumers**

**7.11** Consumers will benefit from the additional requirements, which should reduce the likelihood that unsuitable personal recommendations or decisions to trade will be made.

**References**

**7.12** The current rules are set out in COBS 9.

**7.13** The new provisions are set out in:

- Article 25(2) of MiFID II
- Articles 54 and 55 of the MiFID II delegated regulation

## 8. Appropriateness

### Who should read this chapter

Firms conducting MiFID or equivalent third country business and firms conducting non-MiFID business (including Article 3 firms) which distribute products to retail and professional clients without providing a personal recommendation or a portfolio management service

Consumers and consumer organisations

### Introduction

- 8.1** We explained in DP15/3 that MiFID introduced a distinction between products considered either ‘non-complex’ or ‘complex’ for product sales that are not made through a personal recommendation or provided by a portfolio management service. This categorisation is not generally aimed at consumers. It is used by firms to determine whether they need to conduct an appropriateness test when distributing a particular product without advice.
- 8.2** An appropriateness test is a test by the firm to understand the knowledge and experience of the client. It enables a firm to assess whether a particular product or service is appropriate for that client.
- 8.3** The appropriateness test applies to all complex products, and products deemed complex cannot be sold execution-only. They are also unlikely to be sold through any direct offer financial promotion, as it is difficult to see how an individual assessment of necessary knowledge and experience of the customer could be undertaken.
- 8.4** In DP15/3, we drew firms’ attention to the narrowing under MiFID II of the products classified as ‘non-complex’ and the consequent widening of the scope of products to be made subject to the appropriateness test. We also sought views on whether the MiFID II requirements should be extended to insurance-based investment and pension products. We asked:
- ‘..Q3: Assuming IDD does not replicate MiFID II in terms of the appropriateness test, should we look to apply MiFID II’s appropriateness test to sales of insurance-based investments and pensions?..’
- 8.5** We received 37 responses to this question, which showed mixed views on whether the MiFID requirements should be extended to insurance-based investments and pensions if the IDD did not replicate the MiFID II requirements. Respondents expressed particular concern that extension to pensions would cause difficulties due to the UK pension reforms.

**8.6** Since publication of DP15/3, the final text of the IDD (Directive EU 2016/97)<sup>40</sup> has been published. It contains provisions on appropriateness in Article 30. We propose to leave implementation of provisions on appropriateness for products covered by the IDD until we consult on implementing the IDD. So this chapter deals only with application of the test to MiFID products. However, we will continue to seek cross-sectoral consistency for conduct standards, and, where possible and desirable, alignment with the MiFID standard for insurance-based investment products and pensions.

#### **Existing provisions**

**8.7** Our current domestic requirements for the appropriateness test are set out in COBS 10. These rules apply to a firm carrying on MiFID business, except where it is making a personal recommendation or is engaged in portfolio management.

**8.8** They generally do not currently apply outside MiFID scope, apart from where a firm ‘arranges or deals in relation to a non-readily realisable security, derivative or a warrant with or for a retail client and the firm is aware, or ought reasonably to be aware, that the application or order is in response to a direct offer financial promotion’.

**8.9** In CP06/9, the Financial Services Authority (FSA, the predecessor to the FCA) explained that MiFID requires the appropriateness test to be applied to non-advised transactions involving MiFID derivatives and warrants by MiFID firms for retail clients, and that the UK’s extended application would additionally cover non-MiFID firms (which would include financial advisers exempt from MiFID under Article 3) and non-MiFID products (for example, sports and political spread betting), in respect of transactions for retail clients resulting from certain promotions.

**8.10** Non-readily realisable securities were added in March 2014 (see PS14/4 on crowdfunding over the internet and the promotion of non-readily realisable securities by other media). COBS 10 also applies indirectly to mutual society shares through COBS 22.2 (Restrictions on the retail distribution of mutual society shares), which says ‘The firm must assess whether investment in the mutual society share is appropriate for the retail client, complying with the requirements in COBS 10 as though the firm was providing non-advised investment services in the course of MiFID or equivalent third country business’.

**8.11** The current rules will continue to apply to a non-MiFID firm when it arranges or deals in a non-readily realisable security, derivative or warrant for a retail client, and (through COBS 22.2) where a retail client wishes to buy mutual society shares. The new provisions for MiFID firms and products (in the new COBS 10A in Appendix 1) will not apply to non-MiFID products, pending consultation on implementation of the IDD.

#### **Proposals**

**8.12** In broad terms, Article 25(4) of MiFID II enables a MiFID business firm to provide a limited range of investment services (execution or reception and transmission of orders) to a client without having to assess the appropriateness of the investment product for the client as long as certain conditions are met. One of those conditions is that the investment product should be ‘non-complex’.

**8.13** Article 25(4)(a)(i)-(v) of MiFID II lists some of the types of products which can be regarded as non-complex. Article 57 of the MiFID II delegated regulation sets out criteria for determining whether products not specifically listed in Article 25(4)(a) can be considered to be non-complex.

<sup>40</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L0097&from=en>

**8.14** The non-complex criteria that were introduced by MiFID are reflected in COBS 10.4.1R(3). Article 57 of the MiFID II delegated regulation introduces two new criteria which must also be satisfied in order for a product to be regarded as non-complex. These are that the product:

- does not incorporate a clause, condition or trigger that could fundamentally alter the nature or risk of the investment or pay out profile, such as investments that incorporate a right to convert the instrument into a different investment (see Article 57(d)), and
- does not include any explicit or implicit exit charges that have the effect of making the investment illiquid even though there are technically frequent opportunities to dispose of, redeem or otherwise realise it (see Article 57(e))

**8.15** Apart from restriction of the products which can be regarded as non-complex, the only changes of substance are:

- that, where a bundle of services or products is envisaged, the firm must consider whether the overall bundled package is appropriate, and
- a specific requirement for firms to keep records of appropriateness assessments, including, where a warning was given to a client, whether the client decided to go ahead despite the warning and whether the firm accepted the client's request to go ahead with the transaction

**8.16** Our view of the MiFID II provisions on complex and non-complex financial instruments is that, as in MiFID, Non-UCITS Retail Schemes (NURS) and investment trusts are neither automatically non-complex nor automatically complex. They need to be assessed against the criteria in the MiFID II delegated regulation. When firms apply these criteria, they should adopt a cautious approach if there is any doubt as to whether a financial instrument is non-complex.

**8.17** We do not have any discretion to apply requirements which are additional to those in MiFID II and the delegated regulation. We have copied out relevant sections of the MiFID II delegated regulation in the new draft of COBS 10A. We have also transposed relevant sections of the MiFID II. Where we apply provisions of the copied out delegated regulation as rules to firms in respect of non-MiFID business, we have 'translated' some words and phrases used into Glossary terms. A table at the beginning of COBS 10A sets out the directive terms and equivalent Handbook Glossary definitions.

**Q30: Do you agree that, for non-MiFID firms, we should limit the current rules in COBS 10 to direct offer financial promotions relating to a non-readily realisable security, derivative or a warrant (and also, through COBS 22.2, to mutual society shares)? If not, please give reasons why.**

**Q31: Do you agree with our proposal to limit the new COBS 10A to MiFID products? If not, please give reasons why.**

**Q32: Do you have any comments on the new draft of COBS 10A?**

**8.18** ESMA has issued guidelines on complex debt instruments and structured deposits. These guidelines apply from 3 January 2018 – in line with the implementation date of the wider MiFID II package. We have notified ESMA of our intention to comply with these guidelines.

**Implications for firms**

- 8.19** Firms will need to carry out the appropriateness test for a wider range of products than at present. And when offering bundled products and services, they will need to consider the appropriateness of the overall bundle. They will also need to record the results of a test, including, when a warning has been given but the client wishes to proceed with the transaction, and whether they decided to carry out the client's request.
- 8.20** We noted in DP15/3 that firms currently offering products through direct offer financial promotions may be particularly affected by the widening of the scope of complex products. It is unlikely that a firm offering products through a direct offer financial promotion will be able to meet the appropriateness test, because the obligation to carry out the test is on the firm, and not the client.
- 8.21** We also noted in DP15/3 that firms might wish to consider the impact on their online distribution models. Simply collecting information on a client's knowledge and experience will not be sufficient, as firms are required to make an assessment of the client's knowledge and experience before a complex product can be sold.
- 8.22** MiFID II does not require us to apply 'analogous' requirements on appropriateness for Article 3 firms, so we are not applying the new requirements in COBS 10A to them. They will continue to come within the scope of the current requirements in COBS 10, which does not specifically exclude these firms, but we consider that it is unlikely to apply to them, in view of the restrictions on the activities they can carry out and the investments they can deal with.

**Implications for consumers**

- 8.23** The widening of the products which must be treated as 'complex' extends consumer protection, as firms will now need to consider whether products are appropriate for individual consumers in more cases than currently required. This should increase the likelihood that consumers are only sold products which are appropriate for them. Firms are not banned from selling a product where a consumer has been given a warning but still wishes to go ahead, but they will need to consider whether to comply with the consumer's request, given existing requirements on firms to act in the best interests of a client.

**References**

- 8.24** Our current rules on appropriateness are in COBS 10.
- 8.25** The new requirements are in:
- Article 25(3) and (4) of MiFID II (Article 25(4) sets out the types of products which can be regarded as non-complex)
  - Article 57 of the MiFID II delegated regulation sets out criteria for determining whether products not specifically listed in Article 25(4) can be considered to be non-complex

## 9. Dealing and managing

### Who should read this chapter

Firms which execute, receive and transmit or place orders for execution, including portfolio managers.

Firms undertaking MiFID or equivalent third country business and firms undertaking non-MiFID business (including Article 3 firms as well as managers of collective investment undertakings)

Consumers and consumer organisations

### Introduction

- 9.1** This chapter covers our proposals for implementing the MiFID II requirements on best execution. This includes client order handling, record keeping of client orders and decisions to deal, transactions limit order display, and personal account dealing.

### Best execution

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#### Introduction

- 9.2** MiFID's best execution requirements have a number of key objectives to:
- ensure protection of investors
  - sustain the integrity of the price formation process
  - promote competition between trading venues in increasingly fragmented markets
- 9.3** These measures represent a core component in the regulation of financial services. They are designed to address information asymmetries and conflicts of interest between investment firms and their clients, and to promote market efficiency by driving client orders to execution venues that offer the best results.
- 9.4** MiFID II does not materially change the current regime. It increases the compliance threshold and details the content of specific disclosures to be made to clients. The new framework moves from a higher-level set of rules to a more prescriptive one, with well-defined organisational and reporting requirements.
- 9.5** The proposals seek to increase the transparency of order execution arrangements and order routing decisions, to facilitate better scrutiny of performance by clients and their agents. This is



fully consistent with the findings of our thematic review (TR 14/13)<sup>41</sup> that the fundamental information asymmetry currently makes client scrutiny difficult.

- 9.6** MiFID II also introduces two new Regulatory Technical Standards (RTS 27<sup>42</sup> and RTS 28)<sup>43</sup>. These set out new reporting requirements for execution venues and investment firms executing client orders with the aim of improving investor protection and transparency over execution quality. RTS 27 requires execution venues to provide quarterly reports on execution quality, both at the venue level as well as for individual financial instruments. RTS 28 requires firms to publish an annual report intended to provide clients with a list of the top five executions venues where they have executed or sent for execution their client orders or decision to deal in the preceding year and a summary of outcomes that have been achieved (issues about which are covered in the Discussion section below).

### Existing Provisions

- 9.7** COBS 11.2 sets out the rules governing best execution. It requires firms to take all reasonable steps to obtain, when executing orders, the best possible results for its clients taking into account the execution factors. Similarly, portfolio managers and receivers and transmitters have a corresponding duty to act in the client's best interest when placing orders with other entities for execution. Under the current framework, firms must establish and implement effective arrangements including an order execution policy and monitor the effectiveness of those arrangements at least annually. It also specifies the type of information firms have to give to their clients and the additional arrangements they have to put in place when dealing with retail clients.
- 9.8** Best execution obligations currently also apply to non-MiFID firms and business where it involves the execution of orders, placing orders for execution as part of portfolio management activity, or the reception and transmission of orders to other entities for execution in MiFID financial instruments.
- 9.9** The best execution rules are dis-applied, modified or not relevant for particular types of non-MiFID business falling within the Specialist Regimes in COBS 18. This includes non-MiFID corporate finance business, non-MiFID energy and oil market activity, other trading of commodity and exotic derivatives by non-MiFID firms, and non-MiFID spread-betting by way of derogations from the Handbook provisions.

### Proposal

- 9.10** Our proposed approach to implementation is to amend the existing COBS 11.2 by transposing the new MiFID II standards into the Dealing and Managing chapter as COBS 11.2A. The MiFID II delegated regulation is directly applicable in the UK for MiFID business and we will include references to these. However, we propose to copy out (in full) the relevant provisions in the MiFID II delegated regulation in our Handbook. This will both indicate how these standards will apply to non-MiFID business but also to improve clarity for MiFID firms.
- 9.11** We propose to retain the existing guidance in COBS 11.2 that stems from recitals in MiFID, as the substance of this guidance also appears as recitals in MiFID II and we consider that these will help to explain the purpose and intent behind the operative provisions. In certain places,

<sup>41</sup> (TR 14/13) *Best execution and payment for order flow*, July 2014.

<https://www.fca.org.uk/static/documents/thematic-reviews/tr14-13.pdf>.

<sup>42</sup> <http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-3333-EN-F1-1.PDF> and

<http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-3333-EN-F1-1-ANNEX-1.PDF>.

<sup>43</sup> <http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-3337-EN-F1-1.PDF> and

<http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-3337-EN-F1-1-ANNEX-1.PDF>.

existing guidance now appears within the articles of MiFID II. In these cases we propose to delete the relevant guidance [as it will now be included as rules].

**9.12** We propose to add new Handbook guidance in relation to four new recitals in MiFID II and its delegated regulation that would serve as useful guidance for firms in understanding their best execution obligations, namely to copy out:

- Recital 24 of MiFID II. This clarifies that when firms deal on matched principal basis (back-to-back trading) executing orders on behalf of clients, it is equivalent to dealing on own account and is subject to the best execution provisions.
- Recital 107 of the MiFID II delegated regulation. This provides that in order to obtain the best possible results for their clients, investment firms should compare and analyse relevant data published by execution venues in accordance with Article 27(3) of MiFID II.
- Recitals 100 and 108 of the MiFID II delegated regulation. These provide that firms may select a single venue for execution of client orders only where they are able to show that that this consistently delivers the best possible results and where they can reasonably expect that the selected entity will enable them to obtain results for clients that are at least as good as the results that they could reasonably expect from using alternative entities for execution. This reasonable expectation should be supported by the execution quality data published in accordance with Article 27 of MiFID II or by internal analysis conducted by the firm.
- Recital 99 of the MiFID II delegated regulation. This provides that when applying the best execution criteria for professional clients, firms will typically not use the same execution venues for securities financing transactions. It mentions that firms' order execution policy should take into account the particular characteristics of SFTs and it should list separately execution venues used for SFTs.

**9.13** While most of the best execution requirements under MiFID II are applicable to firms executing orders, as well as portfolio managers and receivers and transmitters of orders, there are new requirements placed on execution venues. For these requirements we propose to include links to RTS 27 in the Market Conduct sourcebook (MAR). We also propose that the best execution chapter of COBS will include a cross-reference to the relevant provisions in MAR.

***Application of MiFID II best execution rules to non-MiFID business (Article 3 firms and managers of collective investment undertakings)***

**9.14** We propose to:

- extend the MiFID II best execution rules to non-MiFID business (discussed further below), although retain certain modifications<sup>44</sup> to take into account the specific business models of certain firms.
- extend the MiFID II best execution requirements to financial advisers exempt from MiFID II under Article 3. However we intend to moderate the new requirements by exempting them from reporting under RTS 28.
- level-up best execution rules to MiFID II standards for UCITS management companies subject to some modifications to tailor the provisions for collective portfolio management.
- level-up best execution rules to MiFID II standards for small authorised UK AIFMs and

<sup>44</sup> COBS 18 – Specialist regimes.

operators of residual CISs, subject to the current concession as provided in COBS 18.5.4R, which switches off best execution obligations where a small authorised UK AIFMs of an unauthorised AIF and operators of residual CISs only deal with professional clients and the fund documents specify that best execution requirements are dis-applied. In practice, this will mean that many of these firms will not be subject to the enhanced MiFID II best execution standards because they routinely use this exemption.

- Where the best execution provisions apply to small authorised and residual CIS operators, we propose to apply similar modifications to the best execution provision to those that will apply for UCITS management companies. This will be done in COBS 18.5
- Supplement the existing best execution obligations for full scope UK AIFMs and incoming EEA AIFM branches with the MiFID II RTS 28 reporting requirements and also make consequential changes to the references to additional COBS best execution provisions that currently apply to full scope UK AIFMs to reflect the MiFID II changes, although in substance the requirements remain largely the same (these are currently set out in COBS 18.5.4AR).

**9.15** Under the current regime, full scope UK AIFMs are subject to the best execution rules as modified by COBS 18.5.4AR. This is because the AIFMD level 2 regulation mirrors the core best execution obligations as contained in MiFID and the UCITS implementing directive. In order to ensure common standards of transparency and investor protection across collective portfolio management (CPM) activities, we propose to extend the RTS 28 reporting requirements to full scope UK AIFMs.<sup>45</sup> This approach would help ensure greater transparency over best execution obligations and order routing decisions as well as help ensure a level playing field between firms carrying out CPM activity.

**9.16** We intend to undertake further work to consider whether to supplement the best execution obligations that currently apply to full scope UK AIFMs with the other enhancements to the best execution provisions made under MiFID II. This is consistent with our view that the incremental improvements to the regime under MiFID II are equally relevant to AIFM activities and that similar conduct standards should apply to economically equivalent individual or collective portfolio management activities. However, we have not consulted on additional changes at this stage pending a further review of how these are best applied in the context of AIFM activity and the existing EU legislative framework.

**9.17** Similarly, we will consider whether it is still appropriate to retain the concession noted above for small authorised UK AIFMs and residual CIS operators as contained in the existing COBS 18.5.4R.

**9.18** We intend to keep the current disapplication of best execution obligations for non-MiFID corporate finance business and non-MiFID energy and oil market activities as well as the concessionary regime currently applying to trading of commodity and exotic derivatives instruments (which is not energy and oil market business) by non-MiFID firms.

**9.19** Finally, consistent with our general approach to third country firms, we will apply the MiFID II best execution provisions to third country branches as rules.

#### **Implication for firms**

**9.20** To meet the new requirements firms will be expected to update their existing execution arrangements, execution policies and monitoring procedures.

<sup>45</sup> Article 16 of the AIFMD level 2 regulation allows us to use 'at least' the criteria laid down in Section 1 (general principles) of Chapter III (operating conditions for AIFMs) when assessing the AIFM's compliance with article 12(1) AIFMD (general principles).

- 9.21** We expect that the main impact MiFID II will have on firms will arise from the reporting requirements under RTS 27 and RTS 28. ESMA published in September 2015 a comprehensive cost benefit analysis that covers all the expected impacts these new requirements may have on firms.<sup>46</sup>

### **Implications for clients**

- 9.22** The new more comprehensive provisions should strengthen the content and quality of disclosure to clients. They should also provide greater transparency on execution quality and how and where their orders are executed. We expect that the introduction of these new disclosure requirements will reduce information asymmetries between clients and their agents and help them select the firms they wish to work with. These new requirements should also provide clients with the necessary tools to reasonably monitor and challenge their service providers. We expect that these measures should improve competition between execution venues and firms to the ultimate benefit of their clients.
- 9.23** By proportionately extending, the MiFID II standards to certain non-MiFID firms and activities, we will ensure clients benefit from a common, enhanced set of best execution standards. This will improve transparency over execution arrangements and execution performance, for example by Article 3 firms who receive and transmit orders for clients, and collective portfolio managers.

### **Discussion**

#### ***Raising the over-arching best execution standard***

- 9.24** MiFID II enhances the existing best execution framework by strengthening the overarching standard firms must meet in delivering best execution to their clients. It introduces a modification to the best execution high level provision from ‘all reasonable steps’ to ‘all sufficient steps’. This sets a higher bar for compliance, but still places the onus on firms to ensure that the processes they have in place are able to consistently deliver the best outcomes for their clients. This is likely to involve the strengthening of the firms’ systems and controls and require that they reassess whether their execution policies and arrangements deliver the improved outcomes in line with the higher MiFID II standard.

#### ***Changes to disclosure requirements***

- 9.25** The MiFID II best execution regime is more detailed in terms of the content and quality of disclosures to clients. In particular, it clarifies the details that firms are expected to provide in their order execution policies. This is complemented by the new reporting requirements under RTS 28 which requires firms to provide information on order routing decisions and execution quality over the year. We anticipate that there will be some impact on firms in terms of updating their systems, processes and disclosures. However, most of the information required should be readily available to firms under the current regime. These enhanced disclosures are expected to reduce information asymmetries between firms and their clients.
- 9.26** The MiFID II best execution provisions build upon the existing framework. In this regard, the MiFID II provisions make direct references to the conflicts of interest and inducements rules, and explicitly states that investment firms shall not receive any remuneration, discount or non-monetary benefit for routing client orders to a particular trading venue that infringe these rules. We have previously set out our position in TR14/13 and in our Guidance on the practice of payment for order flow (FG12/13),<sup>47</sup> in which we explained that these payments have the potential to influence order routing decisions and are incompatible with the rule on inducements and also risk compromising compliance with our best execution and conflicts of

<sup>46</sup> [http://ec.europa.eu/internal\\_market/securities/docs/isd/mifid/SEC\\_2011\\_1226\\_en.pdf](http://ec.europa.eu/internal_market/securities/docs/isd/mifid/SEC_2011_1226_en.pdf).

<sup>47</sup> “Guidance on the practice of payment for order flow”, May 2012, <http://www.fsa.gov.uk/static/pubs/guidance/fg12-13.pdf>.

interest rules. This new requirement effectively reinforces the ineligibility of these third-party payments when executing orders on behalf of clients.

- 9.27** MiFID II also provides that firms need to include their own costs for the purposes of selecting execution venues and the best possible results for retail clients shall be determined in term of total consideration. The execution policy must also include a clear and prominent warning that any specific instructions from the client may prevent the firm from taking the steps needed to obtain the best possible result. These are not new requirements and should not impact firms that are already complying with the current rules. Rather their inclusion in MiFID II serves as a useful reminder for firms, highlighting their importance as part of the best execution regime.
- 9.28** There are other areas where the provisions contained in MiFID II strengthen the existing best execution obligations. For example, it requires firms executing client orders outside a trading venue to include in their order execution policy information about the implications of this mode of execution. While the current framework already requires firms to inform their clients of the possibility that client orders may be executed outside a trading venue, the new but related provision additionally requires firms to disclose the consequences such as counterparty risk.<sup>48</sup> Where a firm applies different fees depending on the execution venue, it must explain those differences to allow the client to understand the advantages and disadvantages of those venues. Given that these are not entirely new requirements but rather updates to existing provisions, this should not entail any material change in firms' existing arrangements.

#### ***Changes to execution arrangements and practices***

- 9.29** When executing orders or taking decisions to deal in OTC products including bespoke instruments, firms will be required to check the fairness of the price that they are proposing to the client, by gathering market data and where possible by comparing against similar products. One of the areas we highlighted as part of our recent supervisory work on best execution is that where firms are dealing in bespoke instruments, the client may be essentially captive in unwinding that instrument, increasing the likelihood that the client will be reliant on the firm to provide best execution. This new provision appears to recognise the heightened reliance associated with OTC and bespoke instruments, and adds an explicit measure to ensure a good outcome for the client. Again this is not a fundamentally new requirement (given that this could be considered as implicit in the current best execution rule) and should therefore not significantly impact already compliant firms.
- 9.30** Recognising the proliferation of execution venues since the implementation of MiFID, MiFID II updates the requirements for the use of a single execution venue. To demonstrate that they are taking all sufficient steps to achieve the best possible result for client, firms will need to regularly assess the market landscape to determine whether or not there are alternative venues that they could use. This must be supported by the quarterly execution quality data to be published by execution venues under RTS 27. This is not an entirely new provision as the Committee of European Securities Regulators (CESR) in its 2007 Best Execution Q&A had already highlighted the regulatory expectations in this area. This updated provision should only have a minimal impact on firms' arrangements while strengthening investor protection.
- 9.31** As noted above, the MiFID II best execution regime does not require a fundamental review of firms' existing best execution arrangements where they are compliant with their current obligations. Rather, MiFID II introduces more detailed and prescriptive requirements (set out in the MiFID II delegated regulation), the cumulative impact of which raises the overall compliance standard.

<sup>48</sup> Article 66(3)(e) of the MiFID II delegated regulation.

**RTS 27 and RTS 28**

- 9.32** The key changes to the best execution regime stem from the new Regulatory Technical Standards RTS 27 and RTS 28.
- 9.33** We expect firms will have to set up new systems and processes to publish the necessary data to comply with these new reporting requirements. However, these new provisions are expected to improve the information on execution quality provided to clients. This is expected to address information asymmetries between firms and their clients thereby increasing the ability for clients to scrutinise order routing decisions and practices of their service providers and monitor whether their orders were executed in line with the relevant order policies.
- 9.34** These new provisions include requirements for ‘execution venues’ –which includes regulated markets, OTFs, MTFs, Systematic Internalisers, market makers and other liquidity providers – to regularly publish a report containing detailed information about the quality of the execution achieved in the preceding period. The information on execution quality that execution venues must publish under RTS 27 is also expected to improve competition between venues and provide firms with the necessary tools to assess properly the outcome of their execution arrangements.
- 9.35** RTS 28 requires firms executing orders to publish reports setting out the top five venues they sent orders to in the preceding period, and a summary of their execution quality monitoring. The requirements on firms executing orders will also apply to portfolio managers and receivers and transmitters, who will have to disclose the top five firms or entities to which they sent orders for execution.

**Extending to non-MiFID business**

- 9.36** We propose to level up the existing best execution requirements to the MiFID II standard for non-MiFID firms that execute, receive and transmit client orders or decisions to deal. This approach reflects our view that ensuring that clients receive best execution is a fundamental obligation on firms. We discuss our approach further in the CBA chapter.

**Article 3 financial advisers**

- 9.37** Certain financial advisers are exempt from MiFID under Article 3 of the directive. However, these firms are currently subject to the best execution regime as a result of the approach adopted when implementing MiFID.<sup>49</sup> Given that these firms are typically servicing retail clients, we propose to apply the enhanced MiFID II provisions to them so that all consumers benefit from consistent disclosure and investor protection standards.
- 9.38** We believe that implementing the new requirements will not entail any significant material change in firms’ existing arrangements where they comply with their existing regulatory obligations, given that we propose not to extend RTS 28 reporting requirements to these firms in the interests of proportionality. We think it would be inappropriate to apply RTS 28 to Article 3 financial advisers given the limited scope and nature of their activities. While such firms will be required to review their current policies and arrangements to ensure they are meeting the new MiFID II best execution standard of taking all sufficient steps, they should already have most of the necessary arrangements in place to achieve this in line with their current obligations. In any case, we expect firms to review existing policies and procedures at least annually. Furthermore, several of the additional MiFID II disclosure requirements will not be relevant for these firms. For example, given that their activities are limited to the reception and transmission of client orders it is unlikely they will be subject to the requirement to check the fairness of price in relation to OTC products. Rather, the enhanced disclosure requirements that will apply to Article 3 firms under MiFID II are largely an amplification of their current obligations.

<sup>49</sup> [http://www.fsa.gov.uk/static/pubs/handbook/hb\\_notice79.pdf](http://www.fsa.gov.uk/static/pubs/handbook/hb_notice79.pdf).



***Application of MiFID II to UCITS management companies, residual CIS operators and AIFMs***

- 9.39** UCITS management companies are exempt from MiFID when managing UCITS schemes or EEA UCITS schemes. However, the UCITS Directive mirrors certain provisions of MiFID that apply to UCITS management companies when they manage portfolios of investments. These cover the provisions in Article 19 of MiFID. As a result, the best execution obligations that apply to portfolio managers by virtue of Article 19 of MiFID, are analogous to those that apply to UCITS management companies when they manage individual portfolios of investments.<sup>50</sup>
- 9.40** Firms managing collective investment undertakings, such as UCITS management companies carry out economically equivalent activities to MiFID portfolio managers. These firms therefore present similar issues for the purposes of best execution, and so we propose to apply the enhanced MiFID II standards to UCITS management companies. As is the case with MiFID portfolio managers, we expect the increased transparency to positively impact execution quality and monitoring.
- 9.41** UCITS management companies will face some cost impact given they will need to review their existing arrangements and execution policies to reflect the enhanced MiFID II requirements, as relevant. More significantly, they will also need to put systems in place to produce the annual RTS 28 report setting out the top five venues on which they placed or passed orders for execution including a summary of execution quality obtained.
- 9.42** It is worth noting that a significant proportion of the impacted firms already undertake MiFID business or delegate execution to a MiFID firm, so will in any case be required to adhere to the MiFID II standards. As these firms already undertake MiFID business, they would only face an additional cost of extending these requirements to the non-MiFID areas of their business.
- 9.43** We propose to extend the RTS 28 reporting requirements to full scope UK AIFMs and incoming EEA branches of AIFMs. to ensure consistent standards of transparency and investor protection for firms carrying out economically equivalent activities to MiFID portfolio management. We also currently intend to make consequential changes to reflect MiFID II best execution standards only where the additional COBS best execution best execution rules are already applied to these firms (as set out in the existing COBS 18.5.4AR).
- 9.44** Otherwise, the core best execution rules as set out in AIFMD and its implementing legislation (based on the MiFID and UCITS implementing directives) will continue to apply to these firms. However, we will consider whether the other incremental improvements introduced under MiFID II are equally relevant for these firms (aside from RTS 28 reporting requirements), and intend to undertake further analysis in this area. We intend to communicate any proposed additional changes for AIFMs in future publications on MiFID II implementation.
- 9.45** As noted above, we will also further consider the relevance of the current concession for small authorised UK AIFMs of an unauthorised AIF and residual CIS operators (as contained in the existing COBS 18.5.4R) and will similarly communicate any changes to this approach if proposed in future publications.

***Applying MiFID II rules to third country business***

- 9.46** When implementing MiFID, the FSA applied as rules the best execution requirement to third country branches. This was consistent with its overall approach of ensuring such firms were treated no more favourably than branches of EU firms. We are following the same general

<sup>50</sup> Articles 25(1) and recital 19 of the UCITS Implementing Directive.

approach to third country firms in implementing MiFID II and consequently the same specific approach to its best execution provisions.

### References

- 9.47** The existing rules are in COBS 11.2 and COBS 18. 5.
- 9.48** The requirements for best execution are:
- Article 27 of MiFID II
  - Articles 64 to 66 of the MiFID II delegated regulation supplemented by recitals 99 to 108
  - RTS 27 and 28 contain the new reporting requirements for execution venues and investment firms respectively

### Questions

**Q33: Do you agree with our proposed approach to implementing the MiFID II requirements on best execution? If not, how could we amend our proposed approach?**

**Q34: Do you agree with our proposal to add new guidance to the Handbook chapter on best execution? If not, please explain why.**

**Q35: Do you agree with our proposals for non-MiFID business? If not, what alternative approach could we consider?**

## Client order handling

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### Introduction

**9.49** MiFID II does not make any material changes to the client order handling and limit order rules. However, it adds the term 'trading venue' alongside 'regulated market' to reflect changes in market structure under MiFID II. It also introduces additional methods for making client limit orders public and clarifies that the choice of venue must be made in line with the firm execution policy.

**9.50** MiFID II also switches on client order handling provisions for firms when selling or advising clients in relation to structured deposits.

### Existing provisions

**9.51** COBS 11.3 and 11.4 sets out the rules on client order handling including the public display of client limit orders in shares which are not immediately executed.

**9.52** COBS 11.3 sets out the rules in relation to customer order priority, timely execution, aggregation and allocation of client orders. It also requires firms to ensure orders executed on behalf of clients are promptly and accurately recorded and allocated, and take all reasonable steps to ensure the prompt delivery of orders post-settlement. Additionally, it provides a framework for how to handle confidential client information, including a requirement not to misuse such information.



- 9.53** COBS 11.4 sets out rules to facilitate the earliest possible execution of client limit orders in shares admitted to trading on a regulated market when those orders are not immediately executed under prevailing market conditions.
- 9.54** Client order handling obligations currently also apply to non-MiFID firms and business where it involves the execution of orders, placing orders for execution as part of portfolio management or the transmission of orders to other entities for execution in MiFID financial instruments. This includes certain non-MiFID firms such as investment advisors exempt from MiFID under Article 3 and firms carrying out collective portfolio management, including UCITS management companies, small authorised UK AIFMs and residual CIS operators.
- 9.55** Full-scope UK AIFMs or incoming EEA AIFM branches are not covered by COBS 11.3, as they are subject to broadly similar obligations under directly applicable EU provisions under the AIFMD legal framework, although these are not quite as extensive as the provisions of COBS.
- 9.56** However, the rules are not applied to particular types of non-MiFID business falling within specialist regimes in COBS 18, such as non-MiFID corporate finance business and non-MiFID energy and oil market activities.
- Proposal**
- 9.57** We intend to retain two separated Handbook sections for client order handling and limit orders for rules deriving from Article 28 of MiFID II.
- 9.58** We propose deleting all the existing COBS rules and replacing them with transposed provisions of MiFID II for both COBS 11.3 and COBS 11.4.
- 9.59** We intend to replace all of COBS 11.3 rules deriving from the MiFID implementing directive with the full text of the MiFID II delegated regulation. While the general client order handling framework is well known to firms, and the substance of the requirements remains the same, we have decided due to the important nature of these measures to fully transpose the requirements included in the MiFID II delegated regulation into the Handbook. Some of these provisions also have wider reaching regulatory implications that will be made clearer by including them directly in the Handbook, such as the handling of confidential client information and conflicts of interest management when aggregating and allocating client orders.
- 9.60** We intend to clarify that these rules also apply to investment firms when selling or advising clients in relation to structured deposits.
- 9.61** For simplicity and to uphold high level standards of consumer protection we also intend to apply the amended client order handling requirements in the new COBS 11.3 to the same non-MiFID businesses to whom we currently apply COBS 11.3, as noted above, when this business involves the execution of client orders and the placement or transmission of those orders or decisions to deal to other entities for execution. As the substance of the requirements has not changed, this will not have any implications for these firms.
- 9.62** We also propose to apply MiFID II's client order handling requirements as rules to third country branches conducting MiFID business, which is consistent with our existing approach.
- 9.63** We intend to keep the current disapplication of these rules for non-MiFID corporate finance business, non-MiFID energy and oil market activities and full scope UK AIFMs and incoming AIFM branches, which remain subject to relevant requirements under AIFMD.

**9.64** We intend to delete the client limit order rules in COBS 11.4 which derive from the MiFID implementing directive. We propose to replace them with a copy out of the relevant provisions from the MiFID II delegated regulation which are directly applicable in the UK. Those provisions are also well known to firms and have not materially changed beyond the slightly broader scope noted above.

#### **Implications for firms**

**9.65** We do not expect that our transposition approach for MiFID II changes will have any material impact on firms as they introduce limited changes. In the case of client order handling provisions we will copy out in a new COBS 11.3, there should be no impact at all on either MiFID or non-MiFID firms to whom we will apply the rules as the substance is unchanged.

**9.66** For client limit orders, while the scope of these provisions has been broadened in MiFID II, it also provides more options for how such orders can be made public, giving firms more flexibility on how to comply with the limit order display provision. This may lead to better reporting standards and increased market transparency.

**9.67** The requirement on firms to select the trading venues on which they display non-executed client limit orders in line with their execution policy is consistent with requirements that arise from the best execution regime. Firms may need to review whether any additional shares traded on other trading venues outside regulated markets are newly brought into scope, and if so apply a similar client limit order disclosure process for those shares. However, we expect firms would consider any changes as part of their existing obligation to review their execution arrangements at least annually and the disclosure obligation itself remains the same. On that basis, we think there will be minimal costs for firms to enable public disclosure of unexecuted client limit orders for any additional shares, since they will already have connections to venues or data reporting providers that can be used for this purpose.

#### **Implications for clients**

**9.68** Client order handling rules provide an important consumer protection mechanism where a firm executes orders on their behalf by requiring firms to have processes and procedures in place to ensure client orders are handled fairly, including where a firm aggregates orders. However, since these provisions are substantively unchanged under MiFID II, there are no new implications for clients.

**9.69** Client limit order provisions likewise are not substantively changed aside from scope, and ensure transparency of orders where they are not immediately executed. The changes to the scope of the provisions broaden the disclosure application to potentially cover a slightly wider range of instruments, while also providing firms with more flexibility as to how they can make limit order public, which may ultimately have a marginal benefit to clients by increasing market transparency and integrity.

#### **Discussion**

**9.70** MiFID II does not materially amend client order handling rules, and we do not expect firms will have to implement any specific changes to their systems and controls.

**9.71** MiFID II requires that unexecuted client limit orders in shares admitted to trading on a regulated market or a trading venue are publicly displayed; this is to facilitate their earliest possible execution. The provisions in the MiFID II delegated regulation will allow the firm to publish that order via a data reporting service provider located in a Member State of the European Union while until now firms were limited to trading venues. It will provide firms with an additional option they may use at their discretion.

- 9.72** We expect this addition to existing rules should not materially impact already compliant firms but provide them with additional flexibility. We also understand from our conversations with the industry that many firms will probably already have access to such services or will in the future for the purpose of transaction reporting requirements and therefore if they choose to use a data services provider instead of displaying orders on a trading venue it should not cause any change in their current processes and arrangements.
- 9.73** The implementing measures also clarify that the firm must choose the regulated market or MTF on which it will make the client limit order public in accordance with its existing order execution policy. This is not a new requirement, it just reiterates that for retail and professional clients firms need to execute client orders in accordance with their execution policy. This is consistent with our existing regulatory expectations so should not cause a change in approach for compliant firms.
- 9.74** We believe that the same analysis is valid for to non-scope business and therefore consider that our discretionary policy decision to level-up current rules to MiFID II standards for those firms would not lead to material incremental changes in their systems and processes. However it will provide them with the same benefits and ensure a consistent application of our rules across the regulatory perimeter under our supervision.

#### References

- 9.75** The existing rules are in COBS 11.3, COBS 11.4 and COBS 18.
- 9.76** The relevant section of MiFID II for Client order Handling is:
- Article 28 and Recital 105 of MiFID II
  - Articles 63 to 66 and Recitals 114 and 115 of the MiFID II delegated regulation
- 9.77** The MiFIR provision replicating and clarifying the obligations under Article 77 can be found in Articles 13 and 15 of MiFIR and its implementing measures.

#### Questions

- Q36: Do you agree with our proposed approach to COBS 11.3?  
If not, please give reasons why.**
- Q37: Do you agree with our proposed approach to COBS 11.4?  
If not, please give reasons why.**
- Q38: Do you agree with our proposed approach to retain the  
extension of MiFID requirements to non-MiFID business  
and level-up the requirements to MiFID II standards?  
If not, please give reasons why.**

### Record keeping of client orders, decisions to deal and transactions

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#### Introduction

- 9.78** The requirements in the MiFID II delegated regulation for the record keeping of client orders, decisions to deal and transactions have been revised to align with the taxonomy and content of the new transaction reporting regime under MiFIR.

**9.79** As such, the new measures in this area now require firms to record more granular details on the client instruction, the security traded and the different parties involved in the execution of the order. Firms will also be required to record all necessary order references that will allow their records to be matched to the new transaction reporting requirements applicable to trading venues and the exact sequence of the order execution.

**9.80** MiFID II also widens the scope of the record keeping requirements to include transactions that are carried out on own account and order processing. It also brings structured deposits into scope for the enhanced record keeping provisions.

### **Existing provisions**

**9.81** COBS 11.5 sets out the record keeping requirements on firms in respect of each order received from clients, and decisions to deal taken in providing the service of portfolio management. It requires:

- firms to record details of every transaction the firm has executed, and
- firms that transmit client orders to third parties for execution to also record all relevant details of that order.

**9.82** As well as applying the record keeping obligations under COBS 11.5 to MiFID firms and business, the requirements in COBS 11.5 are also applied to certain non-MiFID firms and business, including investment advisors and venture capitalists exempt from MiFID under Article 3 and UK branches of third country firms, where their business involves the execution of orders, placing orders for execution as part of portfolio management or the transmission of orders to other entities for execution in MiFID financial instruments and certain commodity or exotic derivative instruments.

**9.83** The existing requirements are not applied for particular types of non-MiFID business falling within Specialist Regimes in COBS 18, such as non-MiFID corporate finance business, non-MiFID energy and oil market activities and firms carrying out collective portfolio management, which are exempt from MiFID under Article 2, with the exception of small authorised UK AIFMs and residual CIS operators.

**9.84** Alternative investment funds are subject to equivalent provisions under Articles 64 and 65 of EU Regulation 231/2013. UCITS are subject to equivalent provisions contained in our Collective Investment Scheme sourcebook (COLL 6.13) of our Handbook.

### **Proposals**

**9.85** We intend to transpose the MiFID II requirements and copy out the MiFID II delegated regulation provisions for record keeping requirements for client orders, decisions to deal, transactions and order processing. We propose to delete the existing text in COBS 11.5 and copy the text in the MiFID II delegated regulation into a new chapter entitled COBS11.5A.

**9.86** We propose to apply the MiFID II record keeping requirements for client orders, decisions to deal, transactions and order processing to some Article 3 firms. In particular, we will apply the new provisions to article 3 firms providing retail investment advice. However, we propose to not apply the requirements to Article 3 firms carrying out corporate finance business. This is in line with our current position under COBS18.3.3 and is based on the understanding that boutique corporate finance firms are not typically active in the secondary market, and it is not relevant to apply the revised transaction record keeping requirements to them.

- 9.87** We also propose to apply the MiFID II record keeping requirements of orders and transactions as rules to UK branches of third country firms, who are already subject to the current COBS 11.5 requirements.
- 9.88** Currently, COBS 11.5 also applies as rules to small authorised UK AIFMs and residual CIS operators. It also applies to non-MiFID business related to commodity or exotic derivative instruments (by virtue of COBS18.2.5) and Occupational Pension Schemes – non scope business (by virtue of COBS 18.8.1). We are currently not proposing to make any changes to this position in this consultation paper. This would mean that we will keep current COBS 11.5 requirements for these firms but not require the additional transaction reporting entries added under MiFID II. However, we welcome views on whether we should apply the MiFID II transaction record keeping standard to the firms identified in this paragraph to the new MiFID II standards. As a consequential change based on this approach, we also propose to move the record keeping requirements that will continue to apply to these firms to an annex in COBS 18, namely COBS 18 Annex 2. This is to ensure a clear delineation between the current standards and the MiFID II standards.
- 9.89** We also propose to maintain the current approach that does not apply requirements in COBS 11.5 to full-scope UK AIFMs, incoming EEA AIFM branches or UCITS management companies. However, we also welcome the views of respondents to this CP on whether we should consider applying the MiFID II standard to these firms to ensure consistent transaction record keeping standards across MiFID investment services and similar non-MiFID activities such as collective portfolio management.
- 9.90** We also intend to clarify in the Handbook that the revised rules under COBS 11.5A will apply to investment firms and credit institutions when selling or advising clients in relation to structured deposits, as required by MiFID II.

#### ***Implications for firms***

- 9.91** We recognise that the MiFID II record keeping requirements on client orders, decisions to deal, transactions and order processing are more extensive for those firms affected than the existing requirements under COBS 11.5, since it established a greater number of entries (fields) per transaction report that must be recorded.
- 9.92** We anticipate that affected firms will have to update their systems and processes to be able to comply with the new requirements. However, similar changes will also be implemented across the market due to changes in other areas of the Handbook when implementing the transactions reporting requirements stemming from MiFIR. This should reduce the impact on firms stemming solely from the revised record keeping provisions, as we anticipate that this new reporting format will become standardised and so ongoing costs will be low once embedded.
- 9.93** The revised requirements will improve the quality of information affected firms will provide to their clients. They will also enable firms to better demonstrate to both clients and the regulator that they have complied with their regulatory obligations and give the firms improved tools to improve their internal controls and the design of their policies and procedures in areas such as best execution, management of conflicts of interests, and deterrence of market abuse.

#### ***Implications for consumers***

- 9.94** The enhanced record keeping requirements improve transparency on order execution and processing. They will benefit consumers by improving the accountability of firms receiving, transmitting or executing orders or decisions to deal on their behalf.

**9.95** The additional items firms are required to record will improve the information available for resolving disputes with customers and improve the quality of disclosures and information provided to them.

**9.96** Given that the records will enable the regulator to better fulfil its surveillance and enforcement tasks, we believe that the revised record keeping requirements will also lead to increased market confidence and consumer protection. For example these records should help drive a focus on best execution, as poor execution outcomes will be more easily detected.

### ***Discussion***

**9.97** MiFID II requires a record keeping regime that is analogous to the MiFID II standard to be applied to Article 3 firms. The existing requirements under COBS 11.5 already apply to Article 3 retail financial advisers and firms carrying out venture capital business as rules.

**9.98** We consider that given the type of business carried out by Article 3 financial advisers, ie reception and transmission of client orders in MiFID financial instruments, extending the MiFID II standards on record keeping of client orders, decisions to deal, transactions and order processing is reasonable, will support our operational objectives of protecting the consumers and the integrity of the markets, and will fulfil the analogous requirement.

**9.99** While the requirements are not as relevant for Article 3 firms carrying out venture capital business because they are less likely to be undertaking the relevant activities, we believe that where they do undertake the relevant activities, they should comply with the MiFID II requirements. This will ensure the same investor protection standard and the integrity of the markets is protected, as well as to ensure that we can monitor the firms' compliance with their wider regulatory obligations.

**9.100** We believe that the reasons identified in this Chapter are equally valid for applying the enhanced requirements to UK branches of third country firms.

**9.101** Non-MiFID firms carrying out corporate finance business are currently exempt from the requirements under COBS 11.5 on record keeping of client orders and transactions. As discussed earlier in this chapter, we intend to retain this dis-application because these firms are not generally undertaking the relevant activities that the revised provisions apply to. The transactions undertaken by these firms will primarily be on shares of private companies. We therefore believe that the revised rules are unlikely to be applicable to the activities of these firms. Given that these firms will be subject to the new taping requirements and the enhanced general record keeping requirement from revised SYSC 9 provisions, we believe, when taken collectively, that these requirements provide a level of investor protection comparable to the specific record-keeping requirements and meets the requirement of having an 'analogous' regime.

**9.102** We have noted that the record keeping provisions under the current COBS 11.5 also apply to small UK AIFs and residual CIS operators, non-MiFID business related to commodity or exotic derivative instruments and Occupational Pension Schemes for their non-scope business. We intend to continue to apply the current record keeping provisions to these firms. However, we would welcome the view of respondents on whether we should bring these firms and activities up to the enhanced MiFID II standards.

**9.103** We welcome views on whether we should bring other firms unaffected by MiFID II up to the improved standard, primarily collective portfolio managers such as UCITS management companies and full-scope AIFMs. We are particularly keen to understand whether or not industry-wide changes to these transaction records are likely to mean that firms carrying

collective portfolio management will in any case adopt the same record-keeping format over time once MIFID II takes effect.

### References

- 9.104** The existing Handbook provisions on record keeping of client orders, decisions to deal and transactions are under COBS 11.5. The current provisions will move to COBS 18 Annex 2 for those firms currently subject to these requirements but to whom we do not currently propose to apply the revised MiFID II standard.
- 9.105** The application of the Handbook provisions to the different specialist regimes is set out in COBS 18.
- 9.106** The relevant provisions for record keeping of orders and transactions are:
- Article 16(6) of MiFID II
  - Articles 74 and 75 of the MiFID II delegated regulation.
- 9.107** We have copied out these provisions for those affected by MiFID II into a new chapter entitled COBS 11.5A.

### Questions

- Q39:** Do you agree with our proposed approach to implementing the MiFID II requirements on record keeping of client orders, decisions to deal, transactions and order processing to Article 3 firms? If not, please give reasons why.
- Q40:** Do you agree with our proposal to apply the requirements to UK branches of third country firms? If not, please give reasons why.
- Q41:** Please give us your views on whether we should apply the new MiFID II transaction record keeping standard to the following firms, for whom we currently propose to maintain the existing requirements in COBS 11.5 for
- i. Occupational pension schemes
  - ii. Non-MiFID business related to commodity or exotic derivatives
  - iii. Small authorised UK AIFMs and residual CIS operators
  - iv. authorised professional firms with respect to activities other than non-mainstream regulated activities
- Q42:** Please give us your views on whether or not we should consider applying new MIFID II standards on transaction record keeping to the following firms which are not currently subject to COBS 11.5, namely:



- i. **Article 3 exempt corporate finance firms**
- ii. **UCITS Management companies**
- iii. **Full scope UK AIFMS and incoming branches of EE AIFMs**

### Personal account dealing

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#### Introduction

- 9.108** Personal account dealing requirements are designed to ensure that personal dealings of the firm's managers, employees, tied agents or any other relevant person do not create a material conflict of interest with their customers' interests, nor undertake personal transactions that may constitute market abuse. These rules seek to protect clients against practices by individuals with a firm who have access to confidential information on clients and transaction information, such as front-running.
- 9.109** MiFID II does not introduce any changes in the rules currently governing personal transactions. However it does extend these provisions to investment firms or credit institutions selling or advising clients in relation to structured deposits.

#### Existing provisions

- 9.110** COBS 11.7 sets out rules governing personal account dealing. Those rules come from Article 13(2) of MIFID. This states that firms shall establish adequate policies and procedures which are sufficient to ensure compliance of the firm including its managers, employees and tied agents with its obligations under the provisions of this directive as well as appropriate rules governing personal transactions by such persons.
- 9.111** COBS 11.7.1R requires firms to implement and maintain adequate arrangements to prevent relevant persons from entering a personal transaction, advising someone else to enter a transaction, or disclosing information that might lead others to enter into transactions, where such action would give rise to a conflict of interest or where the relevant person has access to inside information or other confidential information.
- 9.112** The arrangements should ensure that the relevant person is aware of restrictions on personal transactions and that the firm is informed promptly of, and keeps a record of, any personal transactions entered into by a relevant person. COBS 11.7 also provides for a limited dis-application of the rules for certain personal transactions, clarifies the scope of the application to relevant persons, and indicates how the rules apply to successive personal transactions
- 9.113** The rules also apply to non-MiFID business including firms exempt from MiFID under Article 3, and UCITS management companies.
- 9.114** COBS 11.7 does not apply to full-scope UK AIFMs or incoming EEA AIFM branches, since they are subject to equivalent, directly applicable standards set out in Article 63 of the AIFMD Commission Delegated Regulation (231/2013).

#### Proposals

- 9.115** We propose to:
- Create a new section entitled COBS 11.7A that transposes the relevant requirements and



Recitals in MiFID II on personal transactions. This section will apply to MiFID investment firms, equivalent third country business and firms exempt from MiFID under Article 3, instead of the current provisions in COBS 11.7. The requirements themselves are unchanged in substance, so the main change is to reflect the new structure of MiFID II. There are no cost impacts for firms.

- Retain COBS 11.7 with minor modifications for other non-MiFID firms that are currently subject to these requirements, including UCITS management companies. Again, these changes do not impact the substance of the requirements and have no cost impact on firms. The modifications include:
  - removing notes that refer to current MiFID provisions
  - adding a new application provision
  - updating two cross references to MiFID to the equivalent provision in MiFID II in COBS 11.7.1(1)(c) and COBS 11.7.3G that remain relevant

#### **Implications for firms**

- 9.116** There should not be any substantive implications for already compliant firms, as this area is fundamentally unchanged under MiFID II.

#### **Implications for consumers**

- 9.117** There should not be any substantive implications for consumers, as this area is fundamentally unchanged under MiFID II and therefore provides the same level of protection to them than the current rules.

#### **Discussion**

- 9.118** The substance of the rules for personal account dealing will be unchanged under MiFID II. The proposed changes are only cosmetic and aimed at aligning the handbook content with the new text structure of MiFID II. However, we do not expect these to necessitate any material change in firms' systems and controls.

- 9.119** We believe that retaining the proposed guidance is important to clarify firms' obligations when applying the rules. Also as MiFID II has removed the rules that govern successive personal transactions from the operative provisions and recast them as a recital, we consider that retaining them as a guidance will indicate to firms how they should approach the rules in that specific context.

#### **References**

- 9.120** The existing rules are in COBS 11.7.
- 9.121** The relevant provisions for personal transactions are:
- Article 16 (2) of MiFID II
  - Articles 28 and 29 and Recital 41 of the delegated regulation

#### **Questions**

- Q43: Do you agree with the approach to implementing the MiFID II requirements on personal transactions? If not, please give reasons why.**

- 9.122** Annex: Items that firms are required to record under COBS 11.5A on record keeping of client orders, decisions to deal, transactions and order processing [Items in bold are new]

## Annexes of MiFID II delegated regulation

### Annex IV

#### Section 1

#### Record keeping of client orders and decision to deal

1. Name and designation of the client
2. Name and designation of any relevant person acting on behalf of the client
3. **A designation to identify the trader (Trader ID) responsible within the investment firm for the investment decision**
4. **A designation to identify the algorithm (Algo ID) responsible within the investment firm for the investment decision;**
5. B/S indicator;
6. Instrument identification
7. Unit price and price notation;
8. **Price**
9. **Price multiplier**
10. **Currency 1**
11. **Currency 2**
12. **Initial** quantity and quantity notation;
13. **Validity period**
14. Type of the order;
15. Any other details, conditions and particular instructions from the client;
16. The date and exact time of the receipt of the order or the date and exact time of when the decision to deal was made. **The exact time must be measured according to the methodology prescribed under the standards on clock synchronisation under Article 50(2) Directive 2014/65/EU.**

## Annexes of MiFID II Delegated Regulation

### Annex IV

#### Section 2

##### Record keeping of transactions and order processing

17. name and designation of the client;
18. name and designation of any relevant person acting on behalf of the client;
19. **a designation to identify the trader (Trader ID) responsible within the investment firm for the investment decision;**
20. **a designation to identify the Algo (Algo ID) responsible within the investment firm for the investment decision**
21. **Transaction reference number**
22. **a designation to identify the order (Order ID)**
23. **the identification code of the order assigned by the trading venue upon receipt of the order;**
24. **a unique identification for each group of aggregated clients' orders (which will be subsequently placed as one block order on a given trading venue). This identification should be indicated "aggregated\_X" with X representing the number of clients whose orders have been aggregated.**
25. **the segment MIC code of the trading venue to which the order has been submitted.**
26. the name and other designation of the person to whom the order was transmitted
27. **designation to identify the Seller & the Buyer**
28. **the trading capacity**
29. **a designation to identify the Trader (Trader ID) responsible for the execution**
30. **a designation to identify the Algo (Algo ID) responsible for the execution**
31. B/S indicator;
32. instrument identification
33. **ultimate underlying**
34. **Put/Call identifier**
35. **Strike price**
36. **Up-front payment**
37. **Delivery type**
38. **Option style**
39. **Maturity date**
40. unit price and price notation;

## Annexes of MiFID II Delegated Regulation

### Annex IV

#### Section 2

##### Record keeping of transactions and order processing

41. price
42. price multiplier
43. Currency 1
44. Currency 2
45. remaining quantity
46. modified quantity
47. executed quantity
48. the date and exact time of submission of the order or decision to deal. The exact time must be measured according to the methodology prescribed under the standards on clock synchronisation under Article 50(2) of Directive 2014/65/EU
49. the date and exact time of any message that is transmitted to and received from the trading venue in relation to any events affecting an order. The exact time must be measured according to the methodology prescribed under the standards on clock synchronisation
50. the date and exact time any message that is transmitted to and received from another investment firm in relation to any events affecting an order. The exact time must be measured according to the methodology prescribed under the standards on clock synchronisation under Article 50(2) of Directive 2014/65/EU
51. Any message that is transmitted to and received from the trading venue in relation to orders placed by the investment firm;
52. Any other details and conditions that was submitted to and received from another investment firm in relation with the order;
53. Each placed order's sequences in order to reflect the chronology of every event affecting it, including but not limited to modifications, cancellations and execution;
54. Short selling flag
55. SSR exemption flag;
56. Waiver flag

# 10.

## Underwriting and placing

### Who should read this chapter

Firms conducting MiFID or equivalent third country business which carry out underwriting and placing activity.

#### Introduction

- 10.1** This chapter covers our proposals to implement the new MiFID II requirements for firms carrying out underwriting and placing activities.

#### Existing provisions

- 10.2** Under our existing conflicts of interest provisions in SYSC 10, we provide some additional guidance for firms on the management of securities offerings. SYSC 10.1.14G reminds firms that, during a securities offering, its duty is to its corporate finance client but that its responsibilities to provide services to its investment clients are unchanged. SYSC 10.1.15G contains guidance on measures a firm may wish to consider including in its conflicts of interest policy in relation to the management of a securities offering.

#### Proposals

- 10.3** We propose to:
- copy out the new MiFID II provisions in Articles 38 to 43 of the delegated regulation on underwriting and placing into a new chapter of COBS
  - delete SYSC 10.1.13G, 10.1.14G and 10.1.15G
  - add a guidance provision in the new COBS Chapter indicating the link to relevant organisational requirements in SYSC
  - apply MiFID II provisions in Articles 38 to 43 of the delegated regulation on underwriting and placing as rules to third country firms

#### Implications for firms

- 10.4** The new requirements in COBS 11A for underwriting and placing will require firms to establish specific measures to ensure compliance, if they do not already exist. There will be resource implications, particularly around the new disclosure requirements.

#### Implications for consumers

- 10.5** The new requirements build on the conflicts of interest principles in SYSC 10 and improve protection by ensuring that firms act in the best interest of their issuer clients. The new disclosure requirements will provide greater transparency to the issuer about possible conflicts of interest

and enable them to make a more informed choice. They will also improve the protections to firms' investment clients that subscribe to securities as part of the offering process.

### Discussion

- 10.6** The MiFID II delegated regulation introduces new underwriting and placing provisions, linked to the MiFID II organisational and conduct requirements, on firms to prevent conflicts of interest and duty to act in the client's best interests. There are currently no specific rules covering underwriting and placing in the Handbook. Prior to the introduction of MiFID, there was more detailed guidance on underwriting and placing activities within COB 5.1. When MiFID was implemented, this guidance was replaced with the current guidance in SYSC 10.1, though our regulatory expectations around the management of a securities offering remained unchanged. The new provisions in the MiFID II delegated regulation introduce specific requirements for firms to manage conflicts of interest and to disclose information relevant to underwriting and placing activities, which require a change in the Handbook.
- 10.7** A number of conflicts of interest can arise during underwriting and placing activities. For example, firms carrying out this activity could make allocation recommendations that advance their own interests, rather than those of the issuer client. Indeed, we have found examples of this behaviour in our supervisory work, such as firms suggesting allocations to their top-dealing clients or their own asset management arms. Our market study of investment and corporate banking found that, in equity markets, allocations of shares are skewed towards buy-side investors from whom banks derive greater revenues from other business lines such as trading commission. These risks were further highlighted in the Myners Report<sup>51</sup> on the use of IPOs in government primary share disposals, following the Royal Mail privatisation. A further conflict of interest risk in this area is if the pricing of an offering promote the underwriting and placing firm's own interests, rather than those of the issuer client.
- 10.8** Current conflicts of interest rules in SYSC 10 help to address these risks. They require firms to identify record and manage conflicts of interest, and these apply to underwriting and placing activities. Moreover, pursuant to SYSC 10.1.15G, firms should agree allocation and pricing objectives with the issuer. Many of the new underwriting and placing requirements introduced under MiFID II now add rigour to what is expected by of firms but are fully consistent with SYSC 10. For example, Article 39 of the delegated regulation contains requirements to identify, prevent or manage conflicts of interest in relation to pricing of an issue, whilst Article 40 contains requirements in relation to placing, including the need to involve the issuer client in the placing process and obtaining its agreement to allocation proposals.
- 10.9** There is also a new requirement in Article 43 to keep records of allocation decisions taken to provide a complete audit trail throughout the underwriting and placing process. This builds on SYSC 10.1.6R, where firms are required firms to maintain timely records of the kinds of service or activity carried out in which a conflict of interest entailing a material risk of damage to the interest of clients has arisen or may arise.
- 10.10** MiFID II introduces targeted measures specific to underwriting and placing, which are designed to address risks that have emerged across the market in recent years. For example, there is a new provision to ensure the effective management of conflicts of interest arising when firms engage in the placement of financial instruments issued by themselves (or by entities within the same group) to their own clients, including existing depositor clients in the case of credit institutions. Again, this would have already been expected of firms under our overarching conflicts of interest rules in SYSC 10.

<sup>51</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/388660/bis-14-1300-myners-independent-review-for-secretary-of-state-for-business-ipos-and-bookbuilding-in-future-hm-government-primary-share-disposals.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/388660/bis-14-1300-myners-independent-review-for-secretary-of-state-for-business-ipos-and-bookbuilding-in-future-hm-government-primary-share-disposals.pdf).

### References

**10.11** The existing related guidance provisions are in SYSC 10.1.14G and 10.1.15G.

**10.12** The relevant provisions for underwriting and placing are:

- Articles 16(3), 23 and 24 of MiFID II
- Articles 38 to 43 of the MiFID II delegated regulation
- Draft rules implementing this proposal are in COBS 11A

### Questions

**Q44:** Do you agree with our proposed approach to implementing Articles 38 to 43 of the MiFID II delegated regulation on underwriting and placing? If not, please give reasons why?

**Q45:** Do you agree with our proposed approach to apply Articles 38 to 43 of the MiFID II delegated regulation on underwriting and placing to third country branches? If not, please give reasons why.

# 11.

## Investment research

### Who should read this chapter

Firms undertaking MiFID or equivalent third country business and certain firms undertaking non-MiFID business (including some Article 3 firms) which produce and disseminate investment research.

### Introduction

**11.1** This chapter covers our proposals to implement the MiFID II provisions on the production and dissemination of investment research. Our proposals to implement the Market Abuse Regulation (MAR) provisions on investment recommendations were covered in CP15/35 and the subsequent PS16/13.<sup>52</sup>

**11.2** Our proposed Handbook provisions will apply to firms which produce, or arrange for the production of, research that is intended or likely to be subsequently disseminated to clients of the firm or to the public. In line with our current approach to implementing MiFID, as well as applying to MiFID firms, we are also proposing that these will apply as rules to firms conducting equivalent third country business, non-MiFID Energy Market Participants (EMPs) and Oil Market Participants (OMPs) and Article 3 firms carrying out corporate finance business.<sup>53</sup>

### Existing provisions

**11.3** Our current rules require firms to manage conflicts of interest in relation to the financial analysts involved in the production of investment research and other relevant persons whose responsibilities or business interests may conflict with the interests of the persons to whom research is disseminated. These rules build on the conflicts of interest rules in SYSC 10.1. Via the specialist regimes in COBS 18, the rules also apply to non-MiFID EMPs and OMPs, along with firms carrying out corporate finance business. In addition, there is also some guidance relating to disclosures for research recommendations that are in MAR.

### Drivers for change

**11.4** The drivers for change are two-fold: (i) the need to implement MiFID II requirements domestically; (ii) to maintain a level playing field between MiFID firms and all other firms, including third country firms, Article 2 firms EMPs and OMPs, and Article 3 firms carrying out corporate finance business.

### Proposals

**11.5** Our proposed approach is to:

<sup>52</sup> <https://www.fca.org.uk/firms/markets/market-abuse/mar>

<sup>53</sup> In line with the overall approach to Article 3 firms proposed in this Consultation Paper, the investment research requirements apply to a broader population of firms than suggested here. However, we consider these requirements to be most relevant to Article 3 firms carrying out corporate finance business.



- copy out the MiFID II provisions in Articles 36 and 37 of the MiFID II delegated regulation on investment research into a single COBS chapter, and delete the rules implementing MiFID currently in COBS 12.2 and 12.3
- add new guidance to clarify the application of the new COBS chapter to both investment research and non-independent research
- copy out recitals 50 to 56 from the MiFID II delegated regulation into the new COBS chapter and delete guidance derived from MiFID recitals currently in COBS 12.2
- retain domestic guidance under COBS 12.2.11G and 12.2.13G within the new COBS chapter
- retain the substance of the current 12.3.4G within the new COBS chapter
- retain the current COBS 12.2.12G within the new COBS chapter
- apply MiFID II provisions in Articles 36 and 37 on investment research as rules to third country firms
- via the Specialist Regimes chapter of COBS, reflect that provisions in Articles 36 and 37 of the MiFID II delegated regulation on investment research apply, as rules, to non-MiFID EMPs and OMPs and Article 3 firms carrying out corporate finance business.

#### **Implications for firms**

**11.6** The new investment research rules are largely unchanged from the existing regime. There is a new provision which requires the physical separation of analysts, unless it is not proportionate to do so (see 'Discussion' section below). Since the existing provisions in SYSC 10.1 and COBS 12.2 already set out requirements for the use of information barriers, this new provision is unlikely to have a material impact on the way compliant firms manage conflicts of interest about the production and dissemination of research or their potential compliance burdens.

**11.7** Pursuant to COBS 12.3.4G, firms producing and disseminating non-independent research are already expected to take reasonable steps to identify and manage conflicts of interest which may arise in the production of non-independent research. The extension under MiFID II of certain conflicts of interest provisions (as outlined in the 'Discussion' section below) to non-independent research simply makes this an explicit requirement and is, therefore, unlikely to have a material impact on firms.

#### **Implications for consumers**

**11.8** Again, since the existing provisions in SYSC 10.1 and COBS 12.2 already set out requirements for the use of information barriers, this explicit new provision requiring the physical separation of analysts is unlikely to have a material impact on consumers. It should, however, give the recipients of research added reassurance as to its objectivity.

**11.9** The explicit extension of certain conflicts of interest provisions to non-independent research, while unlikely to have a significant effect on market practice for compliant firms, may add an additional layer of protection for investor clients.

#### **Discussion**

**11.10** Provisions under MiFID II are consistent with those in COBS 12.2 and 12.3, with the exception of two changes. The first is an explicit requirement for firms to introduce a physical separation between financial analysts and other persons whose responsibilities or business interests may conflict with the interests of the persons to whom the research is disseminated. Under this new

provision, physical separation should exist unless it is not considered to be appropriate to the size and organisation of the firm, as well as the nature, scale and complexity of its business. In these circumstances, the firm is required to establish and implement appropriate alternative information barriers.

**11.11** The second change is that MiFID II explicitly applies certain conflicts of interest requirements under Article 34(4) of the delegated regulation to producers of research that is not prepared independently (ie what the current COBS 12.3 refers to as non-independent research). However, we consider that it would be helpful to retain a version of the existing reference to SYSC 10 currently in COBS 12.3.4G to remind producers of investment research and non-independent research of their wider obligations under SYSC 10. We also consider that it would be helpful to continue to provide firms with examples of where conflicts of interest can arise when producing and disseminating a non-independent research.

**11.12** Our proposal to copy out the provisions of MiFID II into a single new COBS chapter, rather than retaining the current structure of COBS 12.2 and 12.3, follows from the fact that there is no such split in the MiFID II delegated regulation. Since ‘non-independent research’ is a UK term (used to describe a marketing communication that is not subject to the same conduct standards as investment research), it is not used in MiFID II. To ensure that firms recognise that what the MiFID II text refers to as a ‘marketing communication’ is the same as what is currently referred to as ‘non-independent research’ in the handbook, we propose a piece of guidance to clarify at the beginning of the new COBS chapter, to this effect:

- “This chapter applies to both investment research and non-independent research, the latter of which is not presented as objective or independent and is accordingly considered a marketing communication.”

**Q46: Do you agree with our proposed approach to implementing Articles 36 and 37 of the MiFID II delegated regulation on investment research? If not, please give reasons why.**

**Q47: Do you agree with our proposed approach to apply Articles 36 and 37 of the MiFID II delegated regulation on investment research to third country firms, non-MiFID OMPs and EMPs, and Article 3 firms carrying out corporate finance business, in the same way as the current COBS 12 applies to them? If not, please give reasons why.**

### References

**11.13** The existing rules are at COBS 12.2 and 12.3.

**11.14** The draft Handbook provisions are in COBS 12 (as amended)

**11.15** The relevant provisions for investment research are:

- Articles 16(3) and 24(3) of MiFID II
- Articles 36 and 37 of the MiFID II delegated regulation

## 12. Other conduct issues

### Who should read this chapter

Firms undertaking non-MiFID designated investment business for retail clients, firms undertaking MiFID or equivalent third country business for both retail and professional clients, and firms undertaking non-MiFID collective portfolio management activities

Consumers and consumer organisations

- 12.1** This chapter explains two areas where we propose amendments to the COBS Handbook:
- changes to client agreement provisions in COBS 8
  - changes to our specialist regime section for collective portfolio management, currently set out in COBS 18.5

### Client agreements

#### Introduction

- 12.2** MiFID II enhances a number of our current consumer protection provisions, which are based on MiFID. In particular, there is now an obligation to enter into a written basic agreement with professional as well as retail clients, and this must be done for each investment service or ancillary service, not just for new clients. The MiFID II delegated regulation also goes into more detail on what must be included in a client agreement. However, it amends the record keeping requirement by reducing the retention period to ‘at least the duration of the relationship with the client’, instead of also having a requirement for records to be kept for at least 5 years, if longer than the relationship with the client.

#### Existing Provisions

- 12.3** The current provisions on these matters are set out in COBS 8 and distinguish between:
- client agreements with retail clients, for which fairly detailed requirements are set out in COBS 8.1.3R
  - records of the document or documents agreed between the firm and a client (including a professional client) and the time for which such a record must be kept

#### Proposals

- 12.4** In line with our general approach, we propose to retain the current COBS 8 provisions for non-MiFID business and implement the more detailed MiFID II requirements for MiFID business

(retail and professional clients and eligible counterparties, where relevant). However, we propose to introduce the new MiFID II record keeping requirement for non-MiFID business other than pension transfers, pension conversions, pension opt-outs or Free Standing Additional Voluntary Contributions, for which records will continue to be required to be kept indefinitely. So for both MiFID and non-MiFID business, the requirement will be to keep records for at least the duration of the relationship with the client.

**Q48: Do you agree with our proposed approach for client agreements? If not explain why and provide cost-benefit data.**

**Implications for firms**

**12.5** Firms carrying on MiFID business will need to provide client agreements for professional as well as retail clients. In practice we believe they are likely to do so already and so we do not expect this to be an onerous requirement. The requirements include greater detail on information to be included in client agreements, although again we expect that firms will largely already provide this information to their clients. The new detail consists of:

- a description of the services, and where relevant the nature and extent of the investment advice, to be provided
- in case of portfolio management services, the types of financial instruments that may be purchased and sold and the types of transactions that may be undertaken on behalf of the client, as well as any instruments or transactions that are prohibited
- a description of the main features of any safeguarding services to be provided, including where applicable the role of the firm with respect to corporate actions relating to client instruments and the terms on which securities financing transactions involving client securities will generate a return for the client

**12.6** Firms will be able to keep records for less than five years, if the relationship with the customer lasts for less than five years, except for certain pensions business, where records will continue to need to be held indefinitely. This means firms will be able to decide for themselves whether, and if so, for how long, they wish to keep records after the relationship with a particular client has ended. Given that this is a relaxation of the current requirements, we do not consider there to be any increase in costs for firms.

**Implications for consumers**

**12.7** We do not expect the amended requirements to have any significant impact on retail clients, as they already receive client agreements under the current provisions. However, the more detailed requirements will give them greater information on their investments if firms do not already provide all this information. The relaxation of the record keeping requirements should not have a significant impact on consumers, as firms will be able to keep records for longer than the duration of the client relationship if they consider this appropriate, and it will not affect consumers' rights to make a complaint to the Financial Ombudsman Service.

**References**

**12.8** The current requirements are set out in COBS 8.

**12.9** The provisions on establishing and keeping records are set out in:

- Article 16(6) and Article 25(5) of MiFID II
- Article 58 and Article 73 of the MiFID II delegated regulation

## Specialist regime for collective portfolio managers

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### Introduction

**12.10** Wider changes to COBS under MiFID II, and the substantive extension of selective MiFID II conduct standards discussed in previous chapters above (namely, inducements and research, best execution and taping requirements), mean that we propose to take the opportunity to restructure COBS 18.5 more generally in order to improve its accessibility to CPM firms. These are not intended to change any other requirements, we briefly outline the changes here and refer firms to the draft Handbook instrument.

### Existing Provisions

**12.11** The current provisions are set out in COBS 18.5. They indicate how certain provisions elsewhere in COBS are applied to firms carrying out scheme management activity<sup>54</sup> or for an AIFM, AIFM investment management functions.<sup>55</sup> It selectively applies and modifies these provisions and sets out some additional disclosure and reporting requirements for certain types of CPM activity.

**12.12** The current provisions apply to the following types of firm:

- a UCITS management company
- a full-scope UK AIFM
- a small authorised UK AIFM
- a residual CIS operator
- an incoming EEA AIFM branch

### Proposals

**12.13** We propose to restructure COBS 18.5 by:

- retaining provisions relating to small authorised UK AIFMs and residual CIS operators in COBS 18.5
- moving the provisions relating to full-scope UK AIFMs and incoming EEA AIFM branches into a new COBS 18.5A
- moving the provisions relating to UCITS management companies into a new COBS 18.5B

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<sup>54</sup> This term relates to the management by an operator of the property held for or within the collective investment scheme of which it is the operator, excluding the receiving and holding of client money and safeguarding and administering investments.

<sup>55</sup> This term relates to investment management functions of an AIFM as set out in 1(a) (portfolio management) or (b) (risk management) of Annex I to AIFMD.

**12.14** Each section will contain a new rule on research and inducements, as discussed in Chapter 3 on research and inducements. We will consider modifying the application of these provisions for internally managed AIFs.

**12.15** We propose to include the provisions relating to the adequate information which needs to be provided to retail investors of unauthorised AIFs managed by full-scope UK AIFMs (currently in COBS 18.5.10AR) in COBS 18.5A by copying out the provisions into a new table, rather than cross-referring back to COBS 18.5.

#### **Implications for firms**

**12.16** These changes are intended to improve accessibility to the specialist regime for CPM firms, making the application to different types of CPM firm clearer. While not intended to be substantive, to the extent it makes the application of our rules clearer it may have a margin benefit of reducing firms' compliance costs.

#### **Implications for consumers**

**12.17** We do not expect the amended requirements to have any significant impact on consumers, as these changes are only designed to help firms in access and understand requirements in our COBS Handbook.

#### **Discussion**

**12.18** We welcome views from CPM firms on the proposed restructure, and set out a question below.

#### **References**

**12.19** The current requirements are set out in COBS 18.5.

**Q49: Do you agree with our proposed approach to restructure and amend COBS 18.5 to make it clearer for firms carrying out CPM activity? If not, why not and what alternative approach you would propose?**

## Part II – Other matters

# 13.

## Product governance

### Who should read this chapter

Firms undertaking MiFID or equivalent third country business, and firms undertaking non-MiFID business which are involved in the manufacture or distribution of MiFID products.

Consumers and consumer organisations

### Introduction

- 13.1** This chapter discusses the MiFID II product governance requirements for manufacturers and distributors. By product governance we mean the systems and controls firms have in place for the design, approval, marketing and ongoing management of products throughout their lifecycle to ensure they meet legal and regulatory requirements. In this chapter, references to 'products' include financial instruments and structured deposits.

### Existing Provisions

- 13.2** At present our guidance is based on the Principles for Businesses sourcebook (PRIN), in the Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD).<sup>56</sup> The guidance covers broadly similar matters as the MiFID II product governance requirements.

### Proposals

- 13.3** MiFID II specifically identifies firms' product governance obligations. These obligations require all firms to:
- establish procedures to assess the target market and risks for new products (or product re-issues) that the firm manufactures or distributes
  - ensure Board level accountability for the process
  - ensure compliance oversight of the process
  - employ staff with relevant competence for these roles
  - choose appropriate distribution channels
  - monitor existing products on an ongoing basis to check they function as expected; are sold to the expected target market and remain consistent with the needs of the target market

<sup>56</sup> The RPPD is available here: [https://www.handbook.fca.org.uk/handbook/document/RPPD\\_Full\\_20130401.pdf](https://www.handbook.fca.org.uk/handbook/document/RPPD_Full_20130401.pdf). See also the FSA's discussion on the application of the guidance to collective investment scheme managers: [http://www.fsa.gov.uk/pubs/other/TCF\\_CIs\\_managers.pdf](http://www.fsa.gov.uk/pubs/other/TCF_CIs_managers.pdf) and the guidance on *Retail product development and governance – Structured product review*, March 2012: <http://www.fsa.gov.uk/static/pubs/guidance/fg12-09.pdf>



- take action if they identify problems

**13.4** For firms involved in the manufacture of products there are also requirements to:

- design products that meet the needs of the target market
- stress test the products
- assess that the charging structure is appropriate
- provide relevant information to distributors

**13.5** With regard to distribution, MiFID II also includes provisions requiring firms to:

- gather relevant information from manufacturers
- provide information to manufacturers to help in the manufacturer's regular product reviews
- work together when several distributor firms are involved in the sale of a product

**13.6** We propose to implement MiFID II product governance provisions as rules for firms undertaking MiFID business, for firms that manufacture structured deposits and as guidance for other non-MiFID firms involved that manufacture or distribute of MiFID products. Where appropriate, we have copied existing relevant FCA guidance, such as from the RPPD, into the rules to help explain certain concepts.

**13.7** As mentioned in the Overview, we intend to ensure that we treat branches of third-country investment firms 'no more favourably' than EU/EEA firms. Traditionally, we have applied some organisational requirements as guidance to these firms. This has been where these requirements mainly affect activities carried out at the level of the parent entity and where the home-state regulator has broadly equivalent requirements in place. Manufacturing and distributing financial instruments are activities which can be carried out by either the parent-entity or the branch. However, there is a strong possibility that firms might attempt to circumvent the MiFID product governance requirements if we apply them only as guidance. Therefore, in order to (i) protect investors and the integrity of our markets and (ii) ensure that the branches of third-country investment firms are not treated more favourably than EU/EEA firms, we propose to apply the provisions as rules for the branches of third-country firms.

**13.8** MiFID II obliges us to introduce at least analogous standards for product governance for distribution firms that use the Article 3 exemption. We therefore also propose implementing the provisions as rules for these firms.

#### **Implications for firms**

**13.9** The new rules and guidance will replace broadly equivalent existing guidance in the RPPD. However, there are certain aspects of the MiFID II product governance provisions that go beyond the RPPD, as outlined below.

**13.10** For firms involved in the manufacture of products:

- product design, including product charges, should meet the needs of the target market and the firm should identify groups for whom the product is unlikely to be suitable
- firms should consider the impact of new products on the orderly functioning of the market

- the distribution strategy should meet the needs of the target market
- firms working together to develop a single product should have a written agreement setting out their share of these responsibilities
- the compliance function at the firm should monitor product governance and firm management Boards should have effective control and oversight over the process

**13.11** Firms working together to manufacture a single product should have an agreement setting out their share of these responsibilities.

**13.12** For firms involved in the distribution of products:

- before distributing a product, firms should consider for which target market it is likely to be suitable and any groups for whom it is unlikely to be suitable
- the distribution strategy should meet the needs of the target market
- products should be reviewed regularly to confirm they remain consistent with the target market's needs and make changes to the distribution strategy or other processes if they identify problems
- firms should provide product manufacturers with information on sales and, where appropriate, the regular reviews mentioned above
- the firm's compliance function should monitor product governance
- firms' management Boards should have effective control and oversight over the process
- firms working together to distribute a single product should share information with other firms in the chain

**13.13** For third country firms, the MiFID II product governance requirements would apply to any product manufacturing and distribution from a branch, not products developed by the Parent entity and marketed uniquely in the home state. The distributor product governance requirements would apply to products developed by the Parent entity but marketed in the home state and in the UK/EU.

**Q50: Do you agree with our proposal to apply MiFID II product governance requirements as rules to UK branches of third country firms, on the basis that these requirements have a strong conduct-focus? If not, please give reasons why.**

**Q51: Do you agree with our proposal to apply the MiFID II product governance provisions as rules for firms engaged in MiFID business? If not, please give reasons why.**

**Q52: Do you agree with our proposal to apply the MiFID II product governance provisions as guidance for non-MiFID firms involved in the manufacture or distribution of MiFID products? If not, please give reasons why.**

**Implications for consumers**

**13.14** Good product governance should improve consumer outcomes. It should result in products meeting the needs of one or more identifiable target markets and be sold to clients in the target markets by appropriate distribution channels. Consumers should be more certain that they are able to buy financial products which are designed in their interests and that will work in the way expected.

**Discussion**

**13.15** In the past the general approach to regulating conduct in retail financial services focused on achieving appropriate consumer outcomes by setting standards for sales processes and disclosure. However, this approach was not always effective in preventing detriment.

**13.16** For some years now, we have looked at how firms design products and their ongoing governance procedures to ensure that products function as intended and reach the right customers. We are also willing to intervene more directly in the market if we identify situations where the potential for customer harm is not sufficiently reduced.

**13.17** So, we support the product governance provisions in MiFID II and expect them to lead to improved customer outcomes. The provisions will build on our existing work and the existing RPPD guidance.

**13.18** We expect the provisions to apply in an appropriate and proportionate way, taking into account the nature of the investment product, the investment service, and the target market for the product. This approach takes forward our existing approach, and we therefore expect the introduction of the new provisions to be an evolution of existing standards rather than requiring significant change.

**13.19** We plan to introduce the provisions in a new sourcebook for Product Governance and Product Intervention (PROD). This will include the following elements:

- The Statement of Policy on our use of the FSMA temporary product intervention rule-making power. The statement is currently available in policy statement 13/3<sup>57</sup>, but we consider it will be more readily accessible if we include it in the Handbook. Rather than put them in this new sourcebook, we are likely to add product intervention rules themselves to relevant parts of the Handbook, as we have in COBS 4.12 for distribution restrictions of certain regulatory capital instruments.
- MiFID II provisions as rules for MiFID business, equivalent third country business, and distribution of MiFID products by Article 3 firms.
- MiFID II provisions as guidance for other firms manufacturing and distributing MiFID products.
- The IDD will also introduce product governance provisions for products within scope. In due course, we plan to implement these provisions in a new chapter in the Product Intervention

<sup>57</sup> PS13/3, *The FCA's use of temporary product intervention rules*, March 2013: <http://www.fca.org.uk/static/documents/consultation-papers/fsa-ps13-03.pdf>.

and Product Governance sourcebook (PROD).

- In the future, we can consider whether to move or replace the RPPD with guidance and rules in PROD for other market sectors.

### **References**

**13.20** The existing guidance is in the RPPD

**13.21** The relevant provisions for product governance are:

- Recital 71 and Articles 16(3) and 24(2) of MiFID II
- Recitals 15 to 20 and Articles 9 and 10 of the MiFID II delegated directive

# 14.

## Knowledge & competence requirements

### Who should read this chapter

Firms undertaking MiFID or equivalent third country business which provide investment advice<sup>70</sup> and information<sup>71</sup> to clients on services and financial instruments

#### Introduction

- 14.1** Article 25(1) of MiFID II requires firms engaged in MiFID business to ensure, and be in a position to demonstrate to us, that individuals giving investment advice or information about financial instruments or investment or ancillary services to clients possess the necessary knowledge and competence to fulfil their investor protection obligations.
- 14.2** Pursuant to Article 25(9) of MiFID II, ESMA has also produced Level 3 guidelines<sup>60</sup> on the assessment of knowledge and competence which focus on the attainment of appropriate qualifications and appropriate experience by employees.
- 14.3** We notified ESMA that we intend to comply with the guidelines from 3 January 2018 in line with the implementation of MiFID II.
- 14.4** The guidelines are intended to improve investor protection by increasing the knowledge and competence of employees and the criteria it sets out for the assessment of knowledge and competence includes:
- a proportionate application of knowledge and competence requirements reflecting the scope and degree of the relevant services provided
  - that the level and intensity of knowledge and competence expected for those providing investment advice should be of a higher standard than those only giving information on investment products and services
  - employees to have both an appropriate qualification and appropriate experience
  - flexibility for employees to achieve the required qualification through tests or training courses that meet the criteria set out by the guidelines

58 For the purpose of a correct application of the guidelines, ESMA has referenced its CESR 2010 Q&As on “Understanding the definition of advice under MiFID” which focuses on ‘personal recommendation’.

59 ESMA considers that “giving information” should be read in a broad sense so as to include all situations where employees are put into direct contact with clients in the course of providing any of the investment services defined in the directive. ESMA has provided examples where the provision of information in certain circumstances would be outside the scope of the guidelines eg people at the reception desk who merely distribute brochures.

60 <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-final-report-mifid-ii-guidelines-assessment-and-knowledge>.

- a high level ‘syllabus’ for the knowledge element with an annual review of employees’ knowledge, including action necessary to comply
- flexibility for employees to work under supervision with neither an appropriate qualification nor appropriate experience for a maximum period of four years, unless a shorter period is determined by the CA
- in order to work unsupervised employees must have a minimum of six month’s work experience and an appropriate qualification
- that a supervisor who has both an appropriate qualification and appropriate experience takes responsibility for the provision of the relevant services when the inexperienced employee is providing relevant services under supervision.
- that the compliance function should assess and review compliance with the guidelines and include the result in the report to the management body
- CAs to publish:
  - information on the period of time required to gain appropriate experience
  - the maximum period of time under which an employee lacking an appropriate qualification or appropriate experience is allowed to work under supervision
  - whether the review of employees’ appropriate qualifications should be carried out by the firm or an external body
- CAs to publish:
  - a list of specific appropriate qualifications that meet the criteria of the guidelines
  - where a list of the specific appropriate qualifications that meet the criteria of the guidelines is not published, the CA must publish the guidelines together with characteristics that an appropriate qualification needs to meet in order to comply with the guidelines

### Existing provisions

- 14.5** Under the current MiFID framework investment firms are required to ensure that their employees have the skills, knowledge and expertise necessary to discharge of the responsibilities allocated to them.
- 14.6** The MiFID requirement has been incorporated into our existing training and competence regime which helps to support our consumer protection objective. It aims to ensure that customers in the regulated financial services markets deal with firm employees who are competent.
- 14.7** The regime consists of:
- a high-level ‘competent employees’ rule in SYSC, derived from the MiFID requirement, which requires firms to employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them (including wholesale firms), and
  - more detailed professionalism requirements in our Training and Competence sourcebook (TC) for certain retail activities, including the need to attain an appropriate qualification where relevant.

### Proposals

**14.8** The ESMA guidelines are summarised above and they introduce some concepts which are new to the UK. These include:

- a maximum time period of four years during which employees need to acquire knowledge and competence, and
- a minimum time period of six months for employees to be considered eligible to have acquired appropriate experience.

**14.9** ESMA expects these guidelines to promote greater convergence in the knowledge and competence of employees providing investment advice or information, and in competent authorities when they assess the adequacy of compliance with such requirements. ESMA confirms in the guidelines that in order to ensure a proportionate application of knowledge and competence requirements firms should ensure that employees have the necessary levels of knowledge and competence to fulfil their obligations, reflecting the scope and degree of the relevant services provided.

**14.10** We propose to transpose Article 25(1) of MiFID II in SYSC 5 to apply to all common platform firms. As regards ESMA's guidelines, we propose to achieve compliance with these by amending both TC and SYSC and also publishing material introduced by the guidelines on the FCA website. This will also give firms flexibility when deciding the best approach to comply with the qualification requirement in the guidelines.

**14.11** Our existing TC sourcebook requirements<sup>61</sup> will give effect to:

- the guideline requirement that the CA must publish whether the review of employees' appropriate qualification should be carried out by the firm or an external body, and
- the guideline requirement to publish a list of specific appropriate qualifications that meet the criteria of the guidelines

**14.12** We propose making amendments to TC to give effect to the guideline requirements that employees must have a:

- minimum of six months appropriate experience (as well as an appropriate qualification) before they can be considered eligible to work unsupervised
- maximum time period of four years in which to acquire appropriate knowledge and competence under supervision

**14.13** FAMR made some recommendations<sup>62</sup> that are relevant to both the TC sourcebook and to firms subject to these guidelines. We will consult separately on any changes we may propose.

### Implications for firms

**14.14** The guidelines introduce more detailed knowledge and competence requirements for firms not subject to our TC sourcebook. In particular, the guidelines are relevant to those who provide

<sup>61</sup> TC includes rules and guidance on assessing and maintaining competence, ensuring employees are appropriately qualified, supervised and trained, and that they maintain their competence for their role. Overall firms should ensure employees have the knowledge and competence necessary to comply with the guideline requirements.

<sup>62</sup> FAMR proposed: that the FCA should consult on modifying the time limits for employees to attain an appropriate qualification in TC from the current 30 months to a maximum of 4 years.

investment advice to professional clients and employees that give information to retail and professional clients.

- 14.15** We consider that our existing rules and guidance in TC and SYSC are well placed to help firms meet the guideline requirements. We propose to amend TC to ensure that it is consistent with the guidelines where necessary, otherwise we will expect firms to have regard to the guidelines in relation to the knowledge and competence of their employees and we will reflect this in our approach to supervision.
- 14.16** Firms subject to the guidelines and SYSC requirements but not subject to TC will need to ensure those employees providing relevant services to clients on behalf of the investment firm have the knowledge and competence necessary. This will include ensuring employees are appropriately supervised where they are not sufficiently knowledgeable and competent, and the provision of training to attain and maintain their qualifications and experience.
- 14.17** Certain employees are able to benefit from limited exemptions to the qualification requirements in TC. For example, where they were assessed as competent under a previous regime.<sup>63</sup> We consider that firms to which the guidelines apply would need to ensure compliance with the guidelines with respect to those individuals.

**Q53: Do you agree with our approach to implementing the guidelines in TC and SYSC 5? If not, please give reasons why.**

#### **Implications for consumers**

- 14.18** The purpose of the guidelines is to improve investor protection by increasing the knowledge and competence of employees in investment firms providing information or advice to clients on services and financial instruments across Member States. It is intended that there is a common approach across the EU. Consumers should benefit from these new guidelines through a higher degree of investor protection and service to clients, as well as reduced risks of client detriment and improper conduct.

#### **References**

- 14.19** Existing rules and guidance are in TC and SYSC 5. Firms should also read the guidelines for the assessment of knowledge and competence referred to in this consultation.
- 14.20** Articles 24, 25(1) and 25(9) of MiFID II are the relevant EU provisions.

<sup>63</sup> <https://www.handbook.fca.org.uk/handbook/TC/TP/1/1.html>.



# 15.

## Recording of telephone conversations and electronic communications (taping)

### Who should read this chapter

Firms conducting MiFID or equivalent third country business, Article 3 firms and non-MiFID Investment managers

Consumers and consumer organisations

### Introduction

- 15.1** MiFID II introduces for the first time an EU wide minimum harmonising requirement on firms to record telephone conversations and electronic communications when providing specific client order services that relate to the reception, transmission and execution of orders, or dealing on own account.
- 15.2** We have had a taping regime in place since 2009, which is very similar to the new MiFID II regime which aims to strengthen investor protection, improve market surveillance and increase legal certainty in the interest of firms and their clients. The MiFID II taping provision is minimum harmonising. It allows us to consider whether to extend the recording requirement to other relevant activities undertaken by MiFID Investment firms. To advance our statutory objectives, we propose to continue to apply a taping regime to discretionary investment managers, but remove the current exemption where the calls are recorded by their broker. We will apply the same approach to firms carrying out non-MiFID collective portfolio management activities. We also propose to extend the rules to corporate finance business.
- 15.3** Our domestic regime applies taping requirements to non-MiFID firms where they conduct the relevant activities<sup>64</sup> that fall to be recorded. We believe that the taping regime is a valuable means of gathering evidence in the context of market abuse and related regulatory breaches, and that these provisions are just as relevant to the activities of non-MiFID firms. We therefore propose to retain a taping regime for these firms.
- 15.4** We propose to apply a taping regime to all Article 3 firms (Article 3 firms largely comprise of financial advisory firms and a smaller number of corporate finance boutiques). This is because based on information from the Financial Ombudsman Service the majority of complaints about investments centre on the conversations that happened when they are sold. We think taping conversations between firms and their clients is likely to be an effective way of advancing our consumer protection objective.
- 15.5** However, we remain open, particularly for smaller financial advisers, to considering whether an alternative approach could help us to achieve a similar level of consumer protection in this area as taping but at a lower cost for firms.

<sup>64</sup> COBs11.8.1R.

**15.6** This Chapter explains the changes we propose to make to the Handbook arising from the implementation of MiFID II and our domestic choices following feedback on Chapter 8 of DP15/3.

#### **Existing provisions**

**15.7** Our domestic rules under COBS 11.8 require firms to record and keep records of telephone conversations and electronic communications about certain trading activities for six months. Firms must also take reasonable steps to prevent mobile phones from being used if their use would mean the firm is unable to record. These rules support the overarching PRIN 3 - Management and Control principle.

**15.8** Under our domestic rules, certain activities and persons which would be usually caught by the rules are excluded; this includes corporate finance business, corporate treasury functions, research analysts, retail financial advisers (including where they are investment firms) and persons carrying on back office functions. We also have a qualified exemption from the taping rule for discretionary investment managers.

**15.9** Our domestic regime applies a taping requirement on non-MiFID firms undertaking the relevant trading activities. This includes firms that carry on energy market activity and oil market activity (COBS 18.2) and the activities of collective portfolio managers (full-scope UK AIFMs, small authorised UK AIFMs, residual CIS operators, incoming EEA AIFM branches and UCITS management companies).

#### **Proposals**

**15.10** The MiFID II regime is similar in outcomes but different in detail to our current domestic taping rules in COBS 11.8. We therefore propose to delete COBS 11.8 and replace it with a new chapter in SYSC. This will ensure that all of the MiFID organisational requirements are in one place, and notes the importance of the role of senior management in ensuring firms' compliance with these obligations. Our proposed approach to implementation is to transpose the MiFID II requirements and cross-refer to the provisions in the MiFID II delegated regulation in SYSC.

**15.11** We propose to apply the MiFID II taping regime to a wider range of activities than those required by the directive, namely:

- the service of portfolio management, including removing the current qualified exemption for discretionary investment managers
- corporate finance business
- energy market activity or oil market activity
- the activities of collective portfolio managers (full-scope UK AIFMs, small authorised UK AIFMs and residual CIS operators, incoming EEA AIFM branches and UCITS management companies).

**15.12** MiFID II requires us to apply a taping obligation to financial advisers who are investment firms. We are also consulting on applying the same taping standard to financial advisers who are Article 3 firms.

#### **Implications for firms**

**15.13** Since the overarching requirement to record certain activities already exists in the UK, the new EU requirement is not new to most firms, however there are some differences:

- The retention period is longer than our existing regime (six months). MiFID II requires records to be stored for five years, with the option for the Competent Authority (CA) to extend the requirement to seven years in specific cases.
- The MiFID II provisions require recording of conversations and communications with all clients where these relate to/ intend to lead to the conclusion of a transaction, even where the transaction is not concluded. Under our domestic regime, only such conversations and electronic communications with professional clients and eligible counterparties are caught. The MiFID II provisions apply to all MiFID financial instruments rather than qualifying investments only.<sup>65</sup>
- Under MiFID II, firms will also be subject to more prescriptive organisational requirements, which are set out in the MiFID II delegated regulation.
- Unlike our existing regime, MiFID II does not include any exemptions or exceptions to the requirement to record.

- 15.14** These changes on first reading seem more prescriptive and to have a different focus compared with our domestic regime. We consider, however, that MiFID II is in line with our regulatory expectations; for example requiring training for staff, maintaining a record of employees using a mobile device and monitoring records for compliance with regulatory requirements. Furthermore it subjects firms to the 'reasonableness standard' which enables firms to adopt measures appropriate to their business. As such, the organisational requirements should not cause a material change to firms already subject to a taping requirement under our domestic regime. We have also previously published material to outline our expectations on a number of the requirements including storage and information requests, many of which are still relevant and can be relied upon.<sup>66</sup>
- 15.15** Our proposed application of the MiFID II organisational and administrative taping provisions to the service of portfolio management and our proposed removal of the qualified exemption our rules currently provide for discretionary investment managers will have an impact on those firms who currently rely on this exemption, such as those who do not record. For these firms, there will be one off and on-going costs.
- 15.16** For firms who do not record corporate finance business but already record other activities pursuant to COBS 11.8 or will have to record other activities under MiFID II<sup>67</sup>, only limited costs to extend their recording facilities to this service are envisaged.
- 15.17** As financial advisers are currently exempt from our taping regime, our proposal to require financial advisers which are Article 3 firms to tape will mean that these firms incur costs to install and maintain new equipment, as well as ongoing compliance costs.
- 15.18** For non-MiFID firms currently subject to our taping rules, including those carrying on energy market activity or oil market activity and collective portfolio managers (including UK AIFMs, small authorised UK AIFMs and residual CIS operators, incoming EEA AIFM branches and UCITS management companies), we intend to carry forward their requirement to tape where they undertake the relevant activities, with those amendments that are necessary to align the existing regime with the MiFID II organisational requirements for taping. This will ensure, for example, that the regime applies to MiFID financial instruments rather than to qualifying

<sup>65</sup> Qualifying investments relates to financial instruments under the scope of the Market Abuse Directive. Under the Market Abuse Regulation, the definition of financial instrument is aligned with MiFID II.

<sup>66</sup> [http://www.fsa.gov.uk/pubs/newsletters/mw\\_newsletter28.pdf](http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter28.pdf).

<sup>67</sup> Article 3 firms – corporate finance boutique firms.

investments only, and will align the retention period applicable with that required for MiFID II. We believe the taping regime is valuable for gathering evidence in the context of market abuse and related regulatory breaches, and these provisions are equally relevant to the activities of non-MiFID firms. We do not expect that implementing these measures will be overly resource intensive or costly for these firms, as they are likely to be standard market practice.

- 15.19** For all firms, we expect that the knowledge that telephone conversations and electronic communications will be recorded and readily available to compliance departments and to the FCA will deter a greater proportion of individuals from potentially committing market abuse or demonstrating other behaviours which fail to meet the standards expected of firms in respect to their conduct of business.

#### **Implications for consumers**

- 15.20** These requirements are intended to help prevent, detect and deter market abuse, and help to strengthen firms incentives to complying with conduct of business requirements (such as best execution, client orders handling and inducements obligations). We consider that there will be particular benefits in helping to resolve disputes between firms and their clients. In our view, access to tapes will provide tangible and material benefits to both firms and their clients (irrespective of categorisation) in resolving disputes in a speedy, efficient and cost effective manner.

#### **Discussion**

##### ***Corporate finance business***

- 15.21** Corporate finance business broadly involves advice and arranging activities in respect of underwriting new debt or equity issuances, corporate restructuring, takeovers and acquisitions, and business strategy. Certain corporate finance activities, such as advice and underwriting, will not fall under Article 16(7) of MiFID II. We are therefore keen to address this potential gap in taping in relation to corporate finance business.

- 15.22** Firms (including Article 3 firms) undertaking corporate finance business routinely have access to inside and confidential information, which presents a risk of improper disclosure that could lead to insider dealing and market abuse behaviours, and potentially undermines market integrity. Our proposals to require firms to record corporate finance business aligns with the outcomes of FEMR, which highlighted the benefits of technology to help reduce/remove the scope for poor misconduct in wholesale markets, and our operational objective to protect and enhance market integrity.

- 15.23** From a supervisory perspective, we have seen in our recent thematic review – TR 15/13 ‘Flows of confidential and inside information’<sup>68</sup> – poor systems and controls in respect of the handling of confidential and inside information within these firms. Records of telephone conversations and electronic communications could be a useful tool for firms’ compliance functions and the FCA to assess how the firm is complying with their wider regulatory requirements including management of conflicts of interest which are inherent in the provision of corporate finance business, particularly in respect of underwriting and placing.

##### ***Portfolio management***

- 15.24** Our proposal to continue to require firms to record conversations related to **portfolio management activity and remove the current exemption for discretionary investment managers** is based on our supervisory and enforcement experiences.

<sup>68</sup> TR15/13 <https://www.fca.org.uk/your-fca/documents/thematic-reviews/tr15-13>.

**15.25** We have observed shortcomings with the existing qualified exemption for portfolio managers during investigations. We have faced difficulties in obtaining the relevant records as we only have access to those records from the 'sell-side' firms (eg brokers). Additionally, removing the exemption will ensure that the regulatory and operational burden is shifted to discretionary investment managers, who are often the subject of our investigations. This will reduce the costs and burden on those firms who are not the actual subjects of our enforcement or supervisory investigations.<sup>69</sup>

***Firms exempt from MiFID under Article 3***

**15.26** Taping is one of the areas where we are required to extend 'at least analogous' requirements to firms exempt from MiFID by virtue of Article 3(2). We have considered whether to apply taping or some other requirement with a similar objective to these firms. Article 3 firms largely comprise of financial advisers and corporate finance boutiques. We believe there are many benefits in applying a taping requirement to corporate finance boutiques for the reasons set out above. We also believe there are important benefits from applying a taping requirement to financial advisers.

**15.27** For example, we expect the increase in the sales of investment products to retail clients to continue. However, we are aware that when complaints arise between firms and their clients they often centre around the conversations that happen when the products are sold. Where those conversations take place by telephone, the existence of tapes will therefore provide a clear audit trail of the intention and understanding of the parties leading up to the conclusion of a transaction, particularly in cases when allegations of mis-selling arise. We believe that consumers will also benefit from the self-disciplining deterrent effect on advisers from recording calls. Other benefits include providing supervisors with an additional tool when undertaking thematic reviews or mystery shopping exercises. Access to tapes will also provide our Enforcement division with an additional source of evidence. We also expect the market to become more diverse in the delivery of its advice, which may involve more telephone conversations that support online advice models, making it more important for the regulator to have effective records in light of market innovations and developments in electronic communications.

**15.28** Based on evidence from suppliers, our assessment is that the technology to tape phone conversations has improved and costs have reduced significantly since the FSA introduced the requirement to tape in 2008. We estimate that the cost of technology has fallen by a third. Data retention costs have also fallen significantly since the development of third party cloud storage and we expect this trend to continue.

**15.29** We therefore propose to apply a taping requirement to all **Article 3 firms**. In our view, this can help to reduce instances of misselling and advance our operational objective of securing an appropriate degree of protection for consumers, by providing the FCA with an additional and effective tool to support our supervision and enforcement activities, as well as a means to help firms and consumers resolve disputes more efficiently. Responses to DP15/3 on this issue did not identify a more cost-effective way of achieving an analogous outcome.

**15.30** However, we acknowledge that many concerns were expressed to us in response to DP15/3 about the cost and practical implications for the many very small financial adviser firms amongst the Article 3 firm population. After considering the responses to DP15/3, we are open to receiving and exploring suggestions on alternative proposals for smaller financial advisers. Any alternative proposal must meet an analogous outcome to a taping requirement in terms of securing equivalent consumer protection benefits, and include a clear articulation of the costs

<sup>69</sup> If we want to obtain the recordings of discretionary investment managers, we currently have to contact a numerous and wide ranging selection of sell-side firms. This slows down our investigations, is unduly burdensome, and very resource intensive on those firms.

and relevant benefits, together with a reasoned view of where the delineation between smaller and larger advisory firms could be drawn in practice.

**15.31** For firms undertaking energy market activities or oil market activities, we considered whether it is still relevant to require these firms to record their telephone conversations and electronic communications relating to the relevant activities. We think that retaining a taping regime on these firms remains appropriate because of their activities in the commodities markets.

### References

**15.32** The existing rules are at COBS 11.8, COBS 18.2, COBS 18.3, COBS 18.5.

**15.33** The relevant provisions for taping are:

- Articles 3.2(c) and 16(7) of MiFID II
- Article 76 of the MiFID II delegated regulation.

### Questions

**Q54:** Do you agree with our proposed unified approach to implementing the MiFID II requirements on taping of telephone conversations and electronic communications? If not, please give reasons why.

**Q55:** Do you agree with our proposed approach for Article 3 firms including larger financial advisors? If not, please give reasons why. In your response, please identify the size of your firms eg provide details of the number of employees who will be subject to the new taping requirements.

**Q56:** Do you agree with our approach for Article 3 financial advisers? If not, what other alternatives do you suggest that may meet the analogous requirements of Article 3.2(c) of MiFID II for smaller financial advisers? Please also provide your views on what an appropriate threshold level to distinguish between larger and smaller financial advisers would be.

**Q57:** Do you agree with our approach to extend the MiFID II requirements to corporate finance business and the service of portfolio management and to remove the exemption for discretionary investment managers? If not, please give reasons why.

**Q58:** Do you agree with our proposal to apply the MiFID II taping provisions to UK branches of third country firms?

**Q59:** Some respondents to the CBA we undertook last year indicated that the costs for adhering to the new taping organisational requirements are likely to be minimal. Do you agree with this view? If not, please provide further empirical information as to why.

# 16.

## Supervision manual (SUP), authorisation and approved persons

### Who should read this chapter

Firms conducting MiFID business who are making changes to the composition of their management body and firms who wish to seek authorisation as MiFID firms

#### Introduction

- 16.1** MiFID II requires firms applying for authorisation to provide us with information on their organisational structure and sets out specific requirements concerning the firm's management body.
- 16.2** These requirements are supplemented by detailed RTS and implementing technical standards (ITS) which are included in ESMA's final report, issued on 29 June 2016, on 'MiFID/MiFIR draft technical standards on authorisation, passporting, registration of third country firms and cooperation between competent authorities'.<sup>70</sup> More specifically, the ESMA final report includes:
- RTS under Article 7(4) of MiFID II on information and requirements for the authorisation of investment firms (the Authorisations RTS)<sup>71</sup>
  - ITS under Article 7(5) of MiFID II on notifications by and to applicant and authorised investment firms (the Authorisations ITS).
- 16.3** When the RTS and ITS above are adopted and have come into force, they will be directly applicable under EU law and be legally binding on firms. Article 4 of the Authorisations RTS requires applicants to provide specific information about the management body and the persons who effectively direct the business when seeking authorisation under MiFID II. That information must be submitted to the FCA as part of the firm's initial application. The authorisations ITS require applicants to provide that information by using the template available in Annex I of the Authorisations ITS. In addition, applicant firms are required to submit a list of the members of the management body using the template in Annex II of the Authorisations ITS, while existing authorised firms are required to use the template in Annex III of the same ITS to notify the FCA of any changes to the membership of the management body.
- 16.4** The forms in the authorisations ITS allow applicants to provide information in the forms themselves or by annexing additional information. In view of that, we propose to introduce a new version of Form A<sup>72</sup> which firms may use to provide the information above and which can

<sup>70</sup> Available at: [https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1006\\_-\\_mifid\\_ii\\_final\\_report\\_on\\_mifid\\_ip\\_technical\\_standards.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1006_-_mifid_ii_final_report_on_mifid_ip_technical_standards.pdf).

<sup>71</sup> <http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-4417-EN-F1-1.PDF>.

<sup>72</sup> Form A is a form contained in the FCA Handbook and it must be used where the firm is applying for approval of an individual to perform controlled functions.



be used as an annex to the ITS forms. The proposals focus on the forms in Annexes I and II to the Authorisations ITS.

- 16.5** We plan to open the gateway for firms applying for the new permissions and investment types under MiFID II before 3 January 2018. We will direct at that point all new firms seeking authorisation under MiFID for the first time, such as new firms and existing firms varying their permissions to perform MiFID activities to provide the information required under the Authorisation RTS and to submit the ITS Annexes and the new Form A with their application.
- 16.6** We will provide further details on the process, and forms that firms will have to submit, in a separate MiFID II Application and Notifications Guide that we aim to publish in Q4 2016.
- 16.7** Comments on this chapter should reach us by 31 October 2016, before the deadline for comments on the rest of the CP, to enable us to have the forms in place by early 2017. This is when we want to be able to start receiving applications for authorisation under MiFID II.

#### **Existing Provisions**

- 16.8** Section 59 of FSMA 2000 requires a regulated firm to take reasonable care to ensure that no person performs controlled functions for the firm without previous approval by the FCA, or the PRA, as appropriate. To seek approval for individuals to perform controlled functions (including senior management functions where relevant), firms are required to submit a 'Long Form A'. The relevant forms to be used by firms for the approval of these individuals can be found in SUP 10A Annex 4D, for firms subject to the approved persons regime, or in SUP 10C Annex 2D, for firms subject to the senior managers regime (as explained below, we are not proposing changes to the Long Form A in SUP 10C Annex 2D at this stage). We also direct new applicant firms to use these forms with their initial application for authorisation. When the relevant individuals meet certain conditions, we allow firms to use a shorter version of the relevant Form A ('Short Form A').<sup>73</sup>

#### **Proposals**

##### ***New Form A for MiFID firms***

- 16.9** Annex I and Annex II of the Authorisations ITS do not spell out the information that firms have to provide in accordance with Article 4 of the Authorisations RTS. We propose to introduce a new tailored Form A to help investment firms subject to the approved persons regime submitting all the required information with their initial authorisation application under MiFID. Firms will still have an obligation to submit the relevant forms in Annex I and Annex II of the ITS with their authorisation application under MiFID. However, they will be able to simply cross-refer to the relevant information included in the new Form A. This will avoid unnecessary duplication in the information provided.
- 16.10** The information required by Article 4 of the Authorisations RTS is mandatory, and we have concluded that firms seeking authorisation under MiFID will no longer be able to use a short version of the Form A for the appointment of members of the management body or persons who direct the business.
- 16.11** We do not, at this stage, propose to introduce a new Form A for prospective MiFID Investment firms who will be subject to the senior managers' regime.

<sup>73</sup> For example the individual has previously been approved to perform a controlled function and there have been no changes relevant to the person's fitness and propriety since the previous approval.



**16.12** We have conducted a gap analysis between the information required under the Authorisations RTS and ITS and the information that firms are currently required to submit in the existing Long Form A. Although most of the information to be provided under the Authorisations RTS and ITS is already covered in the existing Long Form A, the Authorisations RTS and ITS require firms to submit some additional information.

**16.13** As a consequence, the new Form A for MiFID firms will include the following information:

- a question requiring the individual's contact telephone number (required by Annex II of the ITS)
- a change Section 4 to which now requires details of the individual's employment history for the past 10 years instead of 5 (required under Article 4(a)(iii) of the RTS)
- a follow-up instruction requiring candidates who have disclosed a criminal offence to provide an official certificate of conviction where available (required under Article 4(a)(v) of the RTS)
- a question asking whether the candidate or the firm are aware of any financial or non-financial interests of the candidate and/or close relatives to members of the management body and key function holders at the firm, its parent, its subsidiaries or shareholders (required under Article 4(a)(ix) of the RTS)
- additional instructions requiring applicants to provide:
  - information on the minimum time that will be devoted to the performance of the function within the firm (required under Article 4(a)(xi) of the RTS)
  - information on human and financial resources devoted to the induction and training of the candidate (required under Article 4(a)(xii) of the RTS)
  - documentation relating to the person's reputation and experience, in particular a list of reference persons including contact information, letters of recommendation; (required under Article 4(a)(iv) of the RTS)
  - information on whether an assessment of reputation and experience as an acquirer or as a person who directs the business has already been conducted (including the date of the assessment, the identity of that authority and evidence of the outcome of this assessment) (Article 4(a)(viii) of the RTS)

**16.14** Where a candidate is currently subject to an ongoing criminal investigation, the RTS requires firms to confirm that fact by providing a declaration of honour (Article 4(a)(v) of the RTS). We consider that the declaration at the end of the new Form A will satisfy this requirement.

**Q60: Do you agree with our proposal to introduce a specific Form A to for applications for the approval of individuals who will be members of the management body or who will effectively direct the business? If not, please give reasons why.**

***Persons who are not members of the management body or who do not direct the business***

**16.15** Prospective MiFID firms will only need to provide the information under Article 4 of the Authorisations RTS for persons who are members of the management body or who effectively direct the business. We have outlined below an indicative list of persons performing controlled functions who might be considered as members of the management body and/or of persons who effectively direct the business of the firm for the purpose of the requirements of the Authorisations RTS and ITS:

- CF1 Director
- CF2 Non-Executive Director
- CF2a Chair of the Nominations Committee
- CF3 Chief Executive
- CF4 Partner
- CF29 Significant Management

**16.16** A firm submitting an application for authorisation under MiFID will have to provide the relevant information on the members of the management body, and on individuals who effectively direct the business, in accordance with the Authorisations RTS and Authorisations ITS for any of the functions listed above and should do so by using the new Form A. However, if the relevant individual is not a member of the management body, or does not effectively direct the firm's business, the firm will not need to provide the information required under the Authorisations RTS and Authorisations ITS for that individual and may continue to use the existing Long or Short Form As, as appropriate.

**16.17** Our proposed approach is consistent with MiFID II and does not extend the information requirements in Article 4 of the Authorisations RTS to individuals who would not otherwise be subject to it. However, we recognise that prospective MiFID firms might find it easier to use one single Form A for all the relevant functions applied for even if the individuals in question are not members of the management body. This could reduce complexity and make the process easier for new applicants. However, it would increase the regulatory information requirements provided by the firm.

**Q61: Do you agree with our proposed approach? If not, please give reasons why.**

**Q62: Do you see merit in allowing prospective MiFID firms to use the new Form As also for the appointment of persons who are not members of the management body or who do not direct the business? If not, please give reasons why.**

**Implications for firms**

**16.18** We aim to make a new Form A available with the new MiFID authorisation forms at the beginning of 2017.

**16.19** The new Form A will have to be submitted, for each member of the management body and person who directs the business, by:

- New firms applying for authorisation to undertake activities under MiFID.
- Existing non-MiFID firms with Part 4A permissions applying for a variation of permissions which will bring them into the scope of MiFID. Since these firms are already known to the FCA, they will only have to use the new Form A for new individuals they plan to appoint. For existing approved persons at the firm who are members of the management body or persons who direct the business, the applicant firm will have the choice of submitting the new Form A together with the ITS Annexes or to simply refer to the original Form A already submitted for the initial approval of these individuals and provide any additional information required under the Authorisations RTS directly in the ITS Annexes
- Prospective Article 3 firms applying for authorisation. Since Article 3 firms must be subject under MiFID II to analogous conditions and procedures for authorisation to those applicable to MiFID firms<sup>74</sup>, our proposal is that Article 3 firms should use the same forms as MiFID firms when applying for authorisation when the gateway opens in 2017.

#### **Forms for Authorised MiFID firms**

**16.20** Article 9(5) of MiFID II requires Member States to require firms to notify the CA of all changes to the management body. The Authorisations ITS requires firms to provide that information using the form in Annex III to the ITS. We are not proposing to require firms to use that form until 3 January 2018. Existing MiFID firms should therefore continue to use the existing Form A (or Form C where a person ceases performing a controlled function) available on Connect for any changes to members to the management body or to persons who direct the business. After 3 January 2018, firms will be required to use the form in Annex III of the ITS. We are considering whether, in such cases, firms are required to provide the information under Article 4 of the Authorisations RTS and are discussing this with ESMA. We will look to make any relevant changes to the forms to be used by authorised MiFID firms in the course of 2017.

#### **RAP Form A**

**16.21** There is currently a separate version of Form A for relevant authorised persons subject to the Senior Managers' Regime (in SUP 10C Annex 2D) (the RAP Form A). We do not, at this stage, propose to make any changes to the RAP Form A for the purposes of making authorisation applications under MiFID. In view of the scope of the SMR, we think it unlikely that any relevant authorised persons will need to use the ITS form between the time when the MiFID II authorisations gateway opens in 2017 and 3 January 2018. In particular, it is unlikely that existing RAPs will need to apply for authorisation under MiFID during that period since many are authorised as credit institutions or are already authorised to undertake MiFID activities. In the event that there is a need to amend the RAP Form A before January 2018, we propose to amend it in line with the amendments to the APR version and will liaise with the PRA. We will consider during 2017 whether it is necessary to amend the RAP Form A for the period after 3 January 2018.

**16.22** Our proposed guidelines for authorisation under MiFID II will provide details on the processes discussed above.

#### **Implications for consumers**

**16.23** These proposals will indirectly increase consumer protection by ensuring that the information on the members of the management body, and on the persons who direct the business, we receive as part of a new investment firm authorisation application meets the standards set by MiFID II.

<sup>74</sup> Article 3(2)(a) of MiFID II.

**References**

**16.24** The relevant provisions are:

- Article 7 of MiFID II and RTS required by Article 7(4) of MiFID II and ITS required by Article 7(5) of MiFID II

# 17.

## Perimeter guidance (PERG)

### Who should read this chapter

This chapter is relevant to regulated and unregulated firms, and individuals performing investment services and activities

### Introduction

- 17.1** MiFID II imposes a series of scope changes supplemented by the MiFID II delegated regulation. Perimeter Guidance (PERG) on several of these new features was consulted on as part of CP15/43 notably in relation to dealing on own account, structured deposits and multilateral systems. We noted then that we would issue a later consultation addressing scope matters to be expanded on in the delegated acts.
- 17.2** This Chapter explains the changes we propose to make arising from those matters not dealt with in our earlier consultation, notably those new elements introduced by the MiFID II delegated regulation including forward foreign exchange (FX), commodity derivatives, and new exemptions for professional firms and commodity derivatives trading. It is based on the draft statutory instruments the Treasury published in March 2015 – please note these were produced for the purposes of consultation and both the drafting and policy may be subject to change. We may need to consult again on the relevant aspects of PERG when the Treasury finalises its statutory instruments. It is also based on the draft of RTS 20 on the ancillary exemption for commercial firms trading commodity derivatives that ESMA provided to the Commission in September 2015. We may need to consult again on the relevant aspects of PERG when the Commission adopts RTS 20.
- 17.3** For ease of consultation, our Handbook text is prepared as if the amendments to PERG in CP15/43 have been made and are in force. We are considering separately, the responses to CP15/43 and will, of course, take account of these when we come to finalise our guidance.

### Existing Provisions

- 17.4** PERG's purpose is to give guidance about the circumstances in which authorisation is required or exempt status available. PERG 2 provides guidance on the activities which are regulated under FSMA and available exclusions. It also contains a map in Annex 2 showing how the FCA's permission regime read across to regulated activities. PERG 13 contains guidance mainly on the scope of MiFID and was first issued in connection with the former Financial Services Authority's transposition of the original MIFID, following which it has been updated to take account of subsequent EU legislation.

### Proposals

- 17.5** In addition to the matters consulted on in CP15/43, we propose to issue guidance on various topics including the following:

- what is a personal recommendation for the purposes of MiFID II?
- what is the scope of the expanded category of financial derivatives, notably in relation to FX products?
- what is the scope of the amended categories of commodity derivatives?
- how are emission allowances treated under MiFID II?
- what is the scope of the exemptions for professional firms and commodity trading firms under MiFID II?

**17.6** We also propose to create a new permission category of ‘binary bets’ to help target effective supervision of those firms doing business in relation to this new category of investments arising under the Treasury’s proposed changes to the RAO.

**17.7** The MiFID II delegated regulation amends the definition of ‘personal recommendation’, which is part of the definition of investment advice, to remove the exclusion where a recommendation is issued exclusively through a distribution channel. PERG 13 is updated to take account of this and provides additional guidance on the status of generic advice and general recommendations under MiFID II.

**17.8** A new provision in the MiFID II delegated regulation (article 10) aims to clarify the scope of derivative contracts relating to currencies which necessitates a change in the scope of domestic regulation, notably in regard to forward FX contracts. We have amended our existing guidance on such contracts in PERG 13 Q30 and included new material to help firms understand the scope of the new regulation. This new guidance includes, in particular, several practical examples of the scope of the ‘means of payment’ exclusion in the MiFID II delegated regulation and an explanation of its exclusion for FX spot contracts.

**17.9** In addition to scope changes to derivative contracts relating to currencies, the MiFID II delegated regulation imposes changes to the current types of commodity derivatives as well as those miscellaneous derivatives within the C10 category. Our PERG 13 guidance is updated to take account of these changes and likewise in the case of emission allowances. More specifically, we have expanded our guidance from CP15/43 on how emission allowances are treated under MiFID II and the interaction of the directive with the emission auction regulation. Similarly, we have updated PERG 2 to explain the relationship between emission allowances and the existing RAO category of emission auction products.

**17.10** The MiFID II delegated regulation also includes provisions supplementing the exemptions from the authorisation requirement for professional firms and commodity trading firms under MiFID II. In the case of professional firms, this guidance should be read in conjunction with the changes to PERG 13 Q39, consulted upon as part of CP15/43.

**17.11** We explain the scope of binary bets within amended article 85 RAO (‘Contracts for differences etc.’) in PERG 2, using a worked example.

#### **Implications for firms**

**17.12** Firms will need to consider whether MiFID II requires them to seek new permissions and passports, which result from the changes in scope in investment services, financial instruments and exemptions. The guidance should help them in this.

**Implications for consumers**

**17.13** The purpose of PERG is to give guidance about the circumstances in which authorisation is required and so is of most relevance to authorised and unauthorised firms. Our proposed guidance may also help consumers guard against dealing with firms and individuals who are not regulated when they should be.

**References**

**17.14** Existing chapters 2 and 13 of the Perimeter Guidance.

**17.15** Chapter 11 of CP15/43 and supporting draft Handbook text in Annex G

**References**

**17.16** The relevant provisions are:

- Article 2 and Annex 1 MiFID II
- Chapter 1 of the MiFID II delegated regulation

**Q63: Do you agree with our proposed amendments to PERG 2 and 13? If not, please indicate where you disagree and why.**

# 18.

## Consequential changes to the Handbook

### Who should read this chapter

Those impacted by the SYSC, and/or IPRU(INV), and/or CASS changes consulted on within CP16/19

### Organisational Requirements

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#### Introduction

**18.1** In CP16/19 we consulted on our main proposed changes to the Senior Management Arrangements, Systems and Controls sourcebook (SYSC) in relation to the requirements on the management body and general organisational requirements arising from MiFID II. These include the impact in SYSC of those requirements that are in an EU directly applicable regulation.

**18.2** This section sets out our proposals for implementing consequential changes to the Handbook derived from the proposed amendments to SYSC 1 Annex 1, SYSC 4 to 9 and SYSC 18F included in CP16/19.

#### Existing provisions

**18.3** The proposed consequential amendments are administrative and they do not reflect any change in policy. Most of them consist of incorporating cross-references to organisational requirements in the EU directly applicable regulation.

#### Proposals

**18.4** We propose to amend the Handbook modules listed below:

- Statements of Principle and Code of Practice for Approved Persons (APER)
- Consumer Credit sourcebook (CONC)
- Decision Procedure and Penalties Manual (DEPP)
- Fit and Proper test for Approved Persons (FIT)
- Insurance: Conduct of Business sourcebook (ICOBS)
- Supervision Manual (SUP)

**Q64: Do you agree with our proposed changes to these modules? If not, how could we amend them?**



## Prudential rules

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### Introduction

- 18.5** This section sets out our proposals for implementing a consequential change to chapter 3 of the Interim Prudential Sourcebook for Investment Businesses (IPRU(INV)).

### Existing provisions

- 18.6** The proposed consequential amendments are administrative and they do not reflect any change in policy. They consist of incorporating cross-references to prudential requirements as a result of the scope of changes in the EU directly applicable legislation.

### Proposal

- 18.7** We propose to amend rules 3-60(1) and 3-72 in chapter 3 of IPRU (INV) replacing the current reference to article 2(1)(i) of MiFID with the new reference to article 2(1)(j) of MiFID II.

**Q65: Do you agree with our proposed consequential changes to IPRU(INV) 3? If not, how could we amend them?**

## Client Assets and COBS

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### Introduction

- 18.8** In CP16/19 we consulted on our main proposed changes to the Client Assets sourcebook (CASS) in relation to safeguarding assets and monies belonging to clients.

- 18.9** This section sets out our proposals for implementing consequential changes to the client reporting and information rules (CASS 9) derived from the proposed amendments to COBS 6 and COBS 16 included in Chapter 5 (Disclosure requirements) of this CP.

### Existing provisions

The proposed consequential amendments are largely administrative and incorporate into CASS cross-references to disclosure requirements in a directly applicable EU regulation.

### Proposals

- 18.10** We propose to amend the CASS 9 provisions below to take account of the following:

#### ***Information about safeguarding client financial instruments and money (Article 49)***

- 18.11** CASS 9.4.1G reminds firms of their obligations under COBS 6.1.7R. In relation to For MiFID business, we propose to amend guidance and rules in CASS 9.4 to cross-refer to the new MiFID II requirement (Article 49 of the MiFID II delegated regulation) in COBS 6X.2.6EU. We propose to apply this requirement to such firms when they hold custody assets or client money for all clients. In relation to For non-MiFID business, we propose to retain the existing application of COBS 6.1.7R in CASS 9.4.2R, so that it will apply such firms when they hold financial instruments custody assets or client funds money for all clients. This approach ensures consistency with the proposed changes to COBS and MiFID II, whilst continuing the existing level of consumer protection.

#### ***Statements of client financial instruments or client money (Article 63)***

- 18.12** CASS 9.5 reminds firms of their obligations under COBS 16.4. For MiFID business, we propose to amend guidance and rules in CASS 9.5 to cross-refer to the new MiFID II requirement (Article 63 of the MiFID II delegated regulation) in COBS 16A.4.1EU. The new requirement will increase the minimum frequency of providing statements of client financial instruments

or client money from an annual basis to a quarterly basis for MiFID business. For non-MiFID business, we propose to retain the existing references to COBS 16.4. This approach ensures consistency with the proposed changes to COBS and MiFID II, whilst continuing the existing level of consumer protection.

**Q66: Do you agree with our proposed consequential changes to CASS? If not, how could we amend them?**

# Annex 1

## List of questions

- Q1:** Do you have comments on the general issues raised in this overview, such as: the application of MiFID conduct rules to non-MiFID business; our approach to applying COBS rules to firms selling and advising on structured deposits; and our approach to the structure of COBS?
- Q2:** Do you agree with our proposal to apply the MiFID II inducement rules for independent advice to all advice provided to retail clients? If not, please give reasons why, including evidence as to why, in your view, the costs of such an approach would outweigh benefits.
- Q3:** Do you agree with our proposal to ban firms providing advice or portfolio management services to retail clients from receiving and rebating monetary benefits to such clients? If not, please give reasons why, including evidence as to why, in your view, the costs of such an approach would outweigh benefits.
- Q4:** Do you consider that the ban on receiving and rebating monetary benefits to clients should also apply to professional clients? If so, please explain why and provide cost-benefit data. If not, please give reasons why.
- Q5:** Do you agree that we should apply MiFID II's requirements in relation to inducements to Article 3 firms? If not, please explain why, and also provide cost-benefit data to support your explanation.
- Q6:** Do you agree with our proposal to extend the MiFID II limitation on non-monetary benefits to the wider business of providing advice in respect of RIPs? If not, please give reasons why.
- Q7:** Do you think we should extend the MiFID limitation on non-monetary benefits to the wider business of providing advice for all MiFID products, and not just RIPs? If so, please explain why and provide cost benefit data.

- Q8:** Do you agree with our proposal not to subject advice on structured deposits to our existing RDR adviser charging rules and, instead, to apply only the MiFID II inducement requirements to such business? If not, please give reasons why.
- Q9:** Do you agree with our approach to transpose the MiFID II proposals for the receipt of research linked to the new MiFID II inducement rules as a new COBS 2.3B? If not, please state why and provide any suggestions for an alternative approach.
- Q10:** Do you agree with our approach to extending the research and inducements requirements to firms carrying out collective portfolio management activity? If not, please give reasons why.
- Q11:** Do you agree with proposals to retain some guidance provisions from the existing COBS 11.6 in the new COBS 2.3B section, where they continue to be relevant under the new proposals? If not, please give reasons why.
- Q12:** Do you have any views on areas where we have proposed new guidance provisions to clarify our interpretation of steps firms could take to ensure compliance with the new inducements and research proposals and the detail of the proposals? If not, please give reasons why and any alternative suggestions.
- Q13:** Do you have any views on whether further guidance provisions are needed to clarify other aspects of the new inducements and research proposals and how firms should interpret and implement changes to comply with these provisions? If so, please detail specific aspects on which you think FCA guidance is desirable.
- Q14:** Should we consider any modifications to the requirements linked to the use of RPAs under the inducements and research provisions for full scope UK AIFMs of internally managed AIFs? If so, please provide details on what modifications we should consider and why.
- Q15:** Should we apply the new MiFID II inducements standards to firms carrying out non-discretionary portfolio management activity (as defined in our Handbook glossary), including where they receive third party research, in the same way as for other types of portfolio management? Please provide evidence to support your views.

- Q16:** Do you agree with our approach to revise the quantitative thresholds as part of the opt-up criteria for local authorities by introducing a mandatory portfolio size requirement of £15m? If not, what do you believe is the appropriate minimum portfolio size requirement, and why?
- Q17:** Do you agree with our approach to extend these proposals to non-MiFID scope business? If not, please give reasons why.
- Q18:** Do you agree with our approach to implementing the MiFID II requirements that relate to providing information to clients?
- Q19:** Do you agree with the decision not to extend the 'fair clear and not misleading' information requirements to firms communicating with an eligible counterparty in relation to non-MiFID business? If not, and you think that we should extend the fair, clear and not misleading information requirements to non-MiFID eligible counterparty business, please provide evidence to support your view.
- Q20:** Do you agree with our proposal not to extend the MiFID requirements in relation to costs and charges to non-MiFID business (that is not the business of an Article 3 firm)? Do you think there will be difficulties for firms if they need to comply with different disclosure requirements in relation to costs and charges for their MiFID and non-MiFID business?
- Q21:** Do you agree with our proposal not to propose a standardised format to point-of-sale and post-sale disclosures? If not please give reasons why.
- Q22:** Do you agree with our proposals to amend COBS 16.3 and 16.4 to allow firms doing non-MiFID business to avoid the need to provide their clients with periodic statements, so long as clients have accessed their statements via an on-line system which qualifies as a durable medium? If not please give reasons why.
- Q23:** Do you agree with our analysis of the two (MiFID II and RDR) independence standards? If not, please give reasons why.
- Q24:** Do you agree with our proposal to apply the MiFID standard of independence to financial instruments, structured deposits and other non-MiFID RIPS for UK retail clients? If not, please give reasons why.

- Q25:** Do you agree with our approach to implementing MiFID II's requirements around providing both independent and non-independent (restricted) advice? If not, please give reasons why.
- Q26:** Do you agree with our approach to reading across these further requirements from the MiFID II delegated regulation? If not, please give reasons why.
- Q27:** Do you have any comments on our proposal to keep the current rules for non-MiFID products pending implementation of the IDD? If not, please give reasons why.
- Q28:** Do you have any comments on the new COBS 9A in Appendix 1?
- Q29:** Do you agree that the new COBS 9A should apply in full to Article 3 firms? If not, please give reasons why.
- Q30:** Do you agree that, for non-MiFID firms, we should limit the current rules in COBS 10 to direct offer financial promotions relating to a non-readily realisable security, derivative or a warrant (and also, through COBS 22.2, to mutual society shares)? If not, please give reasons why.
- Q31:** Do you agree with our proposal to limit the new COBS 10A to MiFID products? If not, please give reasons why.
- Q32:** Do you have any comments on the new draft of COBS 10A?
- Q33:** Do you agree with our proposed approach to implementing the MiFID II requirements on best execution? If not, how could we amend our proposed approach?
- Q34:** Do you agree with our proposal to add new guidance to the Handbook chapter on best execution? If not, please explain why.
- Q35:** Do you agree with our proposals for non-MiFID business? If not, what alternative approach could we consider?
- Q36:** Do you agree with our proposed approach to COBS 11.3? If not, please give reasons why.
- Q37:** Do you agree with our proposed approach to COBS 11.4? If not, please give reasons why.

- Q38:** Do you agree with our proposed approach to retain the extension of MiFID requirements to non-MiFID business and level-up the requirements to MiFID II standards? If not, please give reasons why.
- Q39:** Do you agree with our proposed approach to implementing the MiFID II requirements on record keeping of client orders, decisions to deal, transactions and order processing to Article 3 firms? If not, please give reasons why.
- Q40:** Do you agree with our proposal to apply the requirements to UK branches of third country firms? If not, please give reasons why.
- Q41:** Please give us your views on whether we should apply the new MiFID II transaction record keeping standard to the following firms, for whom we currently propose to maintain the existing requirements in COBS 11.5 for
- i. Occupational pension schemes
  - ii. Non-MiFID business related to commodity or exotic derivatives
  - iii. Small authorised UK AIFMs and residual CIS operators
  - iv. authorised professional firms with respect to activities other than non-mainstream regulated activities
- Q42:** Please give us your views on whether or not we should consider applying new MiFID II standards on transaction record keeping to the following firms which are not currently subject to COBS 11.5, namely:
- i. Article 3 exempt corporate finance firms
  - ii. UCITS Management companies
  - iii. Full scope UK AIFMs and incoming branches of EE AIFMs
- Q43:** Do you agree with the approach to implementing the MiFID II requirements on personal transactions? If not, please give reasons why.
- Q44:** Do you agree with our proposed approach to implementing Articles 38 to 43 of the MiFID II delegated regulation on underwriting and placing? If not, please give reasons why?

- Q45:** Do you agree with our proposed approach to apply Articles 38 to 43 of the MiFID II delegated regulation on underwriting and placing to third country branches? If not, please give reasons why.
- Q46:** Do you agree with our proposed approach to implementing Articles 36 and 37 of the MiFID II delegated regulation on investment research? If not, please give reasons why.
- Q47:** Do you agree with our proposed approach to apply Articles 36 and 37 of the MiFID II delegated regulation on investment research to third country firms, non-MiFID OMPs and EMPs, and Article 3 firms carrying out corporate finance business, in the same way as the current COBS 12 applies to them? If not, please give reasons why.
- Q48:** Do you agree with our proposed approach for client agreements? If not explain why and provide cost-benefit data.
- Q49:** Do you agree with our proposed approach to restructure and amend COBS 18.5 to make it clearer for firms carrying out CPM activity? If not, why not and what alternative approach you would propose?
- Q50:** Do you agree with our proposal to apply MiFID II product governance requirements as rules to UK branches of third country firms, on the basis that these requirements have a strong conduct-focus? If not, please give reasons why.
- Q51:** Do you agree with our proposal to apply the MiFID II product governance provisions as rules for firms engaged in MiFID business? If not, please give reasons why.
- Q52:** Do you agree with our proposal to apply the MiFID II product governance provisions as guidance for non-MiFID firms involved in the manufacture or distribution of MiFID products? If not, please give reasons why.
- Q53:** Do you agree with our approach to implementing the guidelines in TC and SYSC 5? If not, please give reasons why.
- Q54:** Do you agree with our proposed unified approach to implementing the MiFID II requirements on taping of telephone conversations and electronic communications? If not, please give reasons why.



- Q55:** Do you agree with our proposed approach for Article 3 firms including larger financial advisors? If not, please give reasons why. In your response, please identify the size of your firms eg provide details of the number of employees who will be subject to the new taping requirements.
- Q56:** Do you agree with our approach for Article 3 financial advisers? If not, what other alternatives do you suggest that may meet the analogous requirements of Article 3.2(c) of MiFID II for smaller financial advisers? Please also provide your views on what an appropriate threshold level to distinguish between larger and smaller financial advisers would be.
- Q57:** Do you agree with our approach to extend the MiFID II requirements to corporate finance business and the service of portfolio management and to remove the exemption for discretionary investment managers? If not, please give reasons why.
- Q58:** Do you agree with our proposal to apply the MiFID II taping provisions to UK branches of third country firms?
- Q59:** Some respondents to the CBA we undertook last year indicated that the costs for adhering to the new taping organisational requirements are likely to be minimal. Do you agree with this view? If not, please provide further empirical information as to why.
- Q60:** Do you agree with our proposal to introduce specific Form As to for applications for the approval of individuals who will be members of the management body or who will effectively direct the business? If not, please give reasons why.
- Q61:** Do you agree with our proposed approach? If not, please give reasons why.
- Q62:** Do you see merit in allowing prospective MiFID firms to use the new Form As also for the appointment of persons who are not members of the management body or who do not direct the business? If not, please give reasons why.
- Q63:** Do you agree with our proposed amendments to PERG 2 and 13? If not, please indicate where you disagree and why.
- Q64:** Do you agree with our proposed changes to these modules? If not, how could we amend them?

**Q65:** Do you agree with our proposed consequential changes to IPRU(INV) 3? If not, how could we amend them?

**Q66:** Do you agree with our proposed consequential changes to CASS? If not, how could we amend them?

## Annex 2

# Cost benefit analysis

1. When proposing rules we must publish a cost benefit analysis (CBA) as required under Section 138I(2)(a) of FSMA, as amended by the Financial Services Act (2012). In CP15/43 we provided an overview of EU work on the impact of MiFID II and its relevance to the UK. We also explained that in implementing MiFID II we would provide a high-level CBA on matters where we have little discretion, but that we would provide a more detailed CBA where we exercise discretion in our implementation. A significant number of the proposals in this CP involve discretion and therefore there much more substantive rather than high-level CBA than in our previous CPs.

### Inducements, including adviser charging

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#### Introduction

2. Our discretionary proposals in Chapter 2 include:
  - applying the MiFID II inducement standard for independent advice also to non-independent (restricted) advice (which we consider is a substantially similar standard to the current COBS 2.3.1), including for structured deposits and Article 3 firms
  - extending the application of the core inducement rules set out in Article 24(9) to Article 3 firms
  - amending the RDR adviser charging rules by applying the MiFID II provisions on non-monetary benefits to the wider business of providing advice on RIPs (in relation to both MiFID RIPs and non-MiFID RIPs)
  - extending the rebating ban to discretionary portfolio management (DIM) for retail clients
3. Our approach to inducements in relation to research is discussed in the next section.
4. The firms affected by these rules and proposals include independent and restricted financial advisers, portfolio managers, product providers, wealth managers and Article 3 firms.

#### Rationale for intervention

##### *Inducement standards applied to restricted advice*

5. MiFID II's inducement ban relates to independent advice only. It does not cover restricted advice. In DP15/3, we asked whether we should copy across MiFID II's inducement ban to cover all advice, ensuring we continue to have clear and consistent standards across advisers domestically.
6. Because our existing rules on inducements – read together with the RDR adviser charging provisions – already substantially meet the MiFID II standard, we consider that it is appropriate to apply the core inducement ban in Article 24(9) to both independent and restricted advice, including in relation to the distribution of structured deposits. This will also apply to Article 3

firms. We consider that it would cause confusion and permit firms to undermine the RDR adviser charging rules if we allowed restricted firms greater flexibility than independent firms over the payments or benefits they can accept from providers and other third parties.

#### ***Application of the core inducement rules to Article 3 firms***

7. Article 3 firms must be subject to requirements 'at least analogous' to those set out in Article 3(2) of MiFID II. Article 24(7) is listed, but the general inducement rule in Article 24(9) is not. We consider that applying the core inducement rule in Article 24(9) to Article 3 firms is a sensible approach; not only as a continuation of current practice, but also to provide a coherent framework for firms to prevent regulatory arbitrage and provider bias in favour of products which provide higher overall remuneration to Article 3 firms, to the detriment of clients.

#### ***Clarifying our expectations on the application of the inducement ban***

8. Our clarification (through amendment of the RDR adviser charging rules) that the inducement rules apply to the wider business of providing advice on RIPs builds on the findings of recent supervisory work and the guidance contained in FG14/1.<sup>75</sup> FG 14/1 clarified that payments which result in, or could have the effect of resulting in, the channelling of business to a particular product provider are not considered to be in line with our inducement rules. In explaining what we believe to be reasonable non-monetary benefits that do not give rise to conflicts of interest, we highlighted a set of common features of such benefits, including that they would need to be reasonable and proportionate, of limited scale and nature, and not result in the advisory firm recovering more than its reasonable costs.
9. Follow-up supervisory work highlighted improvements in the types of inducements distributors are offering to advisory firms, but we remain concerned about the potential for advice to be biased as a result of payments and non-monetary benefits offered by distributors. There continue to be issues around the provision of extravagant hospitality and other benefits that we do not believe meet the inducement rules. In order to address the persistence of these issues, we propose clarifying, also in line with the RDR, that the inducement ban covers the wider business of providing advice to retail clients on RIPs, and not just the provision of a personal recommendation.

#### ***Portfolio management***

10. The MiFID II ban on inducements for portfolio managers (discretionary investment managers) will introduce new obligations in the UK. The current MiFID/RDR bans do not apply to firms conducting discretionary management. MiFID II allows firms to accept, but not retain, third party payments. In effect, this allows the rebating of these payments back to the client.
11. We continue to consider that there are strong arguments that retaining the ability to rebate payments to the client risks introducing provider bias to the detriment of the consumer: this could provide incentives for discretionary managers to choose commission-paying products. When this commission is rebated to the client, it could be seen as 'free money', and suggest discounted charges for the service. So it may, at the very least, cause confusion and hinder transparency about the price the client is paying for the service, and the cost of funds within it. We also propose extending this ban to discretionary management when carried on in relation to non-MiFID scope RIPs.

#### ***Baseline for analysis***

12. *Inducement standards applied to restricted advice*  
Our domestic adviser charging and inducements rules currently apply to all adviser firms, including those providing restricted advice. Under COBS 6, all advisers (both independent and

<sup>75</sup> FCA FG14/1 'Supervising retail investment advice: inducements and conflicts of interest', 2014

restricted) can only be remunerated for personal recommendations to retail clients on RIPs by adviser charges.

13. *Application of the core inducement rules to Article 3 firms in MiFID II Article 24(9)*  
MiFID II requires that Article 3 exempt firms be subjected to a set of requirements 'at least analogous' to those included in Article 24(7). Our current rules on inducements apply to firms in relation to 'designated investment business', with the disclosure requirements applying only in relation to MiFID business or, for Article 3 firms, only when they are providing a personal recommendation in respect of RIPs.
14. *Clarifying our expectations on the application of the inducement ban to RIPs*  
Our Finalised Guidance FG14/1 'Supervising retail investment advice: inducements and conflicts of interest' sets out our expectations of firms on the application of the inducement ban. Therefore, firms should already be familiar with the types of arrangements which we consider as incompatible with the spirit of the RDR.
15. *Extending the rebate ban to discretionary portfolio management for retail clients only*  
MiFID is silent on inducements in relation to portfolio management and our current adviser charging rules do not apply to this activity. The MiFID II inducement standard allows the rebating of fees and commissions and the reception and retention of minor non-monetary benefits.

#### **Costs**

##### ***MiFID II inducement standards apply to restricted advice including in relation to structured deposits***

16. Our domestic adviser charging and inducements rules already apply to firms providing restricted advice. This CBA, therefore, is limited to the potential costs of our discretionary proposal to extend the requirement to firms offering restricted advice in relation to structured deposits.

##### ***Ban on rebating***

17. Of the 201, mainly small, financial advisers responding to our October 2015 MiFID II CBA survey, only a small proportion (8%) stated that they receive inducements related to the sale of structured deposits. An even smaller proportion (2%) indicated that they would incur some costs if they were banned from rebating inducements to clients (and therefore unable to accept inducements at all). Average costs across the 4 firms that provided cost estimates were approximately £2,000 in one-off costs, and £1,700 in ongoing costs. These estimates might not be reflective of the wider adviser population.
18. Given the very small proportion of firms likely to be affected by the ban on rebating in relation to structured deposits, we do not consider the cost impacts to be material.
19. *Extending the ban to restricted advice*  
Of the 40 survey respondents providing restricted advice, a very small proportion (2/3%) receive revenue from advice on structured deposits. An even smaller proportion receive inducements in relation to structured deposits. Firms did not report any likely cost implications of a proposal to ban the receipt and rebating of inducements on these products.
20. Given the very small proportion of restricted advice firms likely to be affected by the ban on accepting and rebating inducements on structured deposits, we consider that the costs would be of minimal significance.

**Application to Article 3 firms of requirements analogous to those in Article 24(9) including in relation to structured deposits**

21. We consider that requiring Article 3 firms to comply with the wider MiFID II core inducement rules would translate into costs of minimal significance. This is because our current rules already apply to Article 3 firms (COBS 2.3.1 applies to firms conducting ‘designated investment business’). However, there is an additional disclosure requirement, which currently applies only to personal recommendations on RIPs and P2P agreements, and the need to apply the quality enhancement test to the inducement, which currently applies only to regulated activities in respect of RIPs and advising on P2P agreements.
22. For Article 3 firms selling or advising on structured deposits, in line with the survey results in relation to our proposal to apply the MiFID inducement standards to restricted advice, we note that fewer than 8% of respondents stated that they receive inducements in relation to structured deposits; and only between 2% and 3% indicated that they would incur some costs if they were banned from rebating inducements to clients. As Article 3 firms will be an even smaller percentage, given the very small proportion of firms affected, we expect that the application of this provision will result in costs of minimal significance.

**Clarifying the scope of the inducement ban**

23. We consider that our proposal to clarify the scope of the inducement ban does not establish new proposals or go beyond the existing guidance as, in practice, FG14/1 already provides firms with extensive material to draw from in setting their compliance approach in line with the spirit of the RDR. FG14/1 also clearly states that *“Payments made/received should always enhance the quality of the service provided to customers. A provider making, or an advisory firm accepting, any payment will create the risk that such a payment is not in line with our rules. If a product provider or advisory firm wishes to take no risk in this area, it should not make or receive such a payment. The making or receiving of such payments will require both firms to satisfy themselves that they comply with the COBS inducements rules.”* Our proposed clarification does not extend the ban beyond this: it re-emphasises the importance of firms considering holistically how payments could result in suboptimal consumer outcomes.
24. In FG14/1, we said that we *“did not consider that we should account for costs incurred by firms knowingly trying to undermine the RDR’s objectives, so the costs to firms of correcting agreements that do not meet the relevant rules are not included.”*
25. In line with our cost-benefit analysis assessment at that time, we continue to believe that the only costs that firms could incur because of our clarification would relate to their decision to perform reviews of their service and distribution agreements and systems and controls. We expect these would result in costs of minimal significance, as most firms should already have the relevant system and controls arrangements in place. Based on our work for FG14/1, we estimate that 3 working days should be sufficient for a typical firm’s legal and compliance functions to conduct the review, with a cost of approximately £1,000 for each agreement.

**Ban on accepting inducements for discretionary managers dealing with retail clients**

26. Our CBA survey indicated that 95% of respondents do not accept and rebate third party payments. Respondents also confirmed that they do not distinguish between MiFID-scope products and non-MiFID RIPs. We therefore do not expect our proposal to extend the ban in relation to those instruments to carry additional costs. Further, none of the respondents that accept inducements indicated that there would be any negative impact from not being able to continue to do so, including on their operating costs, number of clients, or choice of funds.
27. We believe that there would not be any additional costs in implementing our proposal. On the contrary, there may be potential costs savings in the longer term including those stemming

from the reduced complexity of processes and IT arrangements, as firms will no longer be able to accept payments, and so will not need systems to make rebates to retail clients.

#### **Wider impacts**

##### ***MiFID II inducement standards apply to restricted advice including in relation to structured deposits***

28. Banning inducements on non-MiFID financial instruments including structured deposits, could create a more level playing-field which, in turn, may remove incentives for firms to give preference to non-MiFID business in general (and structured deposits in particular) thereby avoiding the risk of regulatory arbitrage.

##### ***Application to Article 3 firms of the core inducement rules in MiFID II Article 24(9) including in relation to structured deposits***

29. There are unlikely to be any wider impacts of these proposals beyond the compliance costs outlined above.

##### ***Inducement ban applied to the wider business of providing advice on RIPs***

30. There are unlikely to be any wider impacts of these proposals beyond the potential for compliance costs outlined above.

##### ***Ban on rebating for discretionary managers***

31. Some respondents to our March 2015 Discussion Paper argued that banning the rebating of inducements for retail clients of portfolio managers would mean adopting a different approach to other Member States. They said this could have an adverse effect on the competitiveness of UK-based discretionary portfolio managers vis-à-vis their European counterparts.
32. We believe the risk of this materialising to be low and would, on the contrary, argue that a ban on rebating could translate into savings for firms given the operational, IT and compliance complexities involved in rebating commissions to clients.

#### **Benefits**

33. We expect there to be minimal incremental benefits, which would build on those envisaged by the RDR, where in our CBA in PS10/06<sup>76</sup>, we estimated benefits of £223m through the prevention of sales of certain investment products. Further analysis in relation to Arch Cru funds indicated that the annual detriment arising from the sales of unsuitable products could be in the range of £0.4bn–£0.6bn.

##### ***MiFID II inducement standards apply to restricted advice including in relation to structured deposits***

34. This ensures that we continue to have clear and consistent standards across advisers domestically, thereby mitigating any risk of regulatory arbitrage and providing an appropriate degree of consumer protection.

##### ***Application to Article 3 firms of the core inducement rules in MiFID II Article 24(9) including in relation to structured deposits***

35. This proposal aims at ensuring that we continue to have clear and consistent standards across the advisory community domestically, thereby mitigating any risk of regulatory arbitrage and providing an appropriate degree of consumer protection.

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***Inducement ban applied to the wider business of providing advice on RIPs***

36. We believe consumers will benefit from our proposals through the full realisation of the benefits envisaged by the RDR. These include a reduction in the risk of provider bias that could arise as a consequence of particularly lavish hospitality offered to distributors by product providers or other benefits that we believe do not meet the inducement rules.

***Ban on portfolio managers accepting (and rebating) inducements in relation to retail clients***

37. We believe this will bring clarity and consistency for clients who may otherwise see the rebate as 'free money' and as discounting the firm's charges.

**Inducements and research****Introduction**

38. We propose to apply the MiFID II standards on inducements received by investment firms offering portfolio management and specifically in relation to the receipt of research to MiFID exempt firms carrying out CPM. These firms include:

- UCITS management companies
- full-scope UK AIFMs
- small authorised UK AIFMs and residual CIS operators
- incoming EEA AIFM branches.

39. As described in the CP Chapter, MiFID II restricts firms providing discretionary individual portfolio management (IPM) services from receiving any material third party non-monetary benefits. However, the MiFID II delegated directive allows investment firms to continue to receive research without breaching the inducement rules by paying for it either:

- Directly, out of the firm's own resources, or
- From a research payment account (RPA) funded by a specific, separate charge to the firm's client. The charge must be agreed and disclosed upfront to the client, be based on a research budget set by the firm and not be linked to execution volumes and values. An RPA is subject to further controls and accountability requirements on the firm.

40. It is worth noting that where a UCITS management company or alternative investment fund manager carries out any MiFID IPM activity, they will be subject to the new requirements in MiFID II due to the cross references set out in Article 6(4) of the UCITS Directive and Article 6(3) of AIFMD respectively.

41. Otherwise, CPM activity is not subject to MiFID II. However, firms carrying out CPM are subject to our domestic use of dealing commission rules in COBS 11.6, which are activated through the COBS specialist regime provisions in COBS 18.5. This means UK firms must comply with consistent standards for IPM and CPM activity.

**Rationale for intervention**

42. Extending the MiFID II requirements to firms providing CPM would address existing market failures established during successive supervisory and policy reviews carried out by us in



the recent years on investment managers' use of dealing commission. The reviews found systematically poor controls by investment managers of the use of dealing commissions to acquire additional research goods and services despite the costs to their clients, with only a small minority of the firms reviewed meeting our expectations.<sup>77</sup> We believe this has led to clients bearing higher costs in dealing commission charges for additional research goods and services than is necessary due to firms applying insufficient scrutiny over total amounts paid for research and whether it adds sufficient value for their clients compared to the costs.

43. We believe extending the MiFID II reforms in this area to firms carrying out CPM will address the market failure observed in the UK. As outlined in the CP Chapter, it will ensure that where these costs are passed by a firm to the fund as an additional cost, it is fair more transparent to the underlying investor and is subject to an appropriate degree of oversight and controls by the firm managing the portfolio. Alternatively, the firm can choose to bear all research costs themselves, giving them a direct incentive to manage external research procurement effectively as a cost of business.
44. It will make CPM firms more efficient in their procurement of research, with the likely impact of reducing costs for investors and / or improving the quality of research consumed on their behalf, and reducing over-consumption and over-production of low quality research in the market. Investment Association figures suggest that retail clients make up 70% of investments in UK authorised funds. By extending MiFID II standards, these clients will benefit from improved incentives on firms to manage costs of third party research purchased as part of their CPM activity and reducing the potential conflicts of interest by enhancing the transparency of benefits received from brokers, preventing items being received in return for transaction commissions or costs.
45. Applying the MiFID II standards to CPM would also remove any perverse incentive for firms that carry out both IPM and CPM activities to seek to pass on higher costs to CPM investors for research that may also benefit a firm's IPM activity. This regulatory arbitrage may occur if less robust requirements applied to CPM activities.
46. An extension of the MiFID II standards on receiving and paying for research would also promote fair competition in the asset management sector as all economically equivalent investment management activity would be subject to the same requirements. As many firms providing CPM delegate the investment management to a MiFID investment firm (either within the same group or to a third party), these funds would still benefit from the application of MiFID II requirements from 2018 if we did not extend the MiFID II standard. However, the funds of any CPM firms who manage assets in-house would not. Having some funds in the market that meet the MiFID II standards while others do not will make cost comparisons difficult for clients may distort competition within the UK.
47. Many asset managers carry out both IPM and CPM activity, managing portfolios to the same strategy and transmitting orders as a single, aggregated transaction to a venue or a broker. This creates efficiencies and economies of scale in their commercial operations, benefits their clients by reducing trading costs and harnesses research and ideas generated by the firms' analysts across multiple portfolios. So by applying common standards on inducements and research for IPM and CPM activities, it reflects and facilitates the integrated nature of dealing and managing

<sup>77</sup> Thematic supervisory work in 2011-12, reported in the FSA Report, 'Conflicts of interest between asset managers and their customers' (November 2012), and supervisory findings in 2014 that were published as part of DP14/3, 'Discussion on the use of dealing commission regime' (July 2014) both highlighted significant shortcomings in firms' controls and oversight of dealing commission used for research in assets managers who generally carried out both IPM of large segregated mandates and CPM of funds.

functions within many asset managers. Most of these firms could not feasibly separate these activities without increasing costs to themselves and their clients.

#### **Baseline for analysis**

- 48.** The MiFID II rules on inducements and research will supersede our rules on the use of dealing commission in COBS 11.6 for MiFID firms carrying out IPM activity. COBS 11.6 also applies to non-MiFID firms carrying out CPM activity in equities and equity-related derivatives. We therefore assume for the purposes of this CBA a baseline as follows:
- For firms carrying out IPM and CPM activity, we assume as the baseline that firms will be upgrading their systems and controls to MiFID II for their IPM activity and that their CPM business was already compliant with our rules in COBS 11.6 and have considered and acted on our relevant publications.
  - In addition, for these firms carrying out IPM and CPM activity, 89% of a sample of firms surveyed (48/54) told us they would in fact scale up their non-MiFID CPM business to the MiFID II standard regardless of our discretionary changes. On that basis, we therefore assume:
    - For the proportion of IPM and CPM firms likely to extend standards anyway, that will form our baseline scenario.
    - For the residual IPM and CPM firms who are unlikely to voluntarily extend MiFID II standards, the baseline for their CPM activity will be our current dealing commission requirements.
  - For firms who only carry out CPM activity with no MiFID permissions for IPM, we assume they comply with our COBS 11.6 requirements and have considered and acted on our relevant publications.
- 49.** We take the view that compliance with COBS 11.6 under our current rules as amended in June 2014 includes firms already having at least the following processes in place, as a baseline for existing costs:
- controls to manage, monitor and reconcile dealing commissions used to pay for research, for example in-house or third party commission management software
  - systems and controls to identify whether goods and services obtained in return for dealing commission charges meets our evidential provisions for substantive research and assists the firm in the provision of its services to clients on whose behalf orders are executed, and budgeting and valuation processes to ensure charges passed on reflect the best interests of their clients,
  - production of client disclosures, including prior disclosure on the nature of dealing commission arrangements and periodic statements at least annually of arrangements entered into, including details of the goods and services received
- 50.** We set out our expectations as part of DP14/3 published in July 2014, with good and poor practices based on our rules. We have observed improvements in practices since then by some firms carrying out both IPM and CPM.
- 51.** The transfer of the existing cost of research itself between the fund and the fund manager, for example, is not considered as a cost of the reforms, but only any net difference in expenditure. Any change in tax treatment of payments for research is not considered as a cost for these purposes, and in any case is also uncertain.

**Costs**

52. We begin our discussion of the costs of the policy proposals with the likely scale of impact across the different groups of firms, and then present the direct cost estimates.

***Likely scope of costs***

53. The scope of costs and CBA discussion below is based on a survey sent to around 200 firms carrying out investment management activities, of which 86 responded. We asked questions relating to the potential extension of MiFID II inducements and research proposals to CPM activity, to which 54 provided responses to qualitative questions, and just over 20 gave more detailed cost estimates relating to adapting MiFID II standards to their CPM business.
54. As noted above, 48 of the respondents to the qualitative questions who carry out both MiFID and non-MiFID Investment management activity stated that they would adopt common procedures across their MiFID and non-MiFID business based on the MiFID II approach. Six firms noted an intention to maintain current standards for their CPM activity rather than the MiFID II standard (assuming as did not impose it on them).
55. We estimate there are 1,044 firms performing some type of CPM activity. Approximately two thirds of this population (670 firms) also have MiFID IPM permissions and so perform both types of activity. This will mean they need to make changes to meet the MiFID II standard for their IPM business anyway. Based on responses noted above, we also assume 89% or 596 firms out of this population intend to read across the MiFID II inducement and research standards to their CPM business regardless of our discretionary decision. This leaves 11% or 74 firms of this 'mixed-scope' firm population who do not intend to do so and therefore would incur more material costs due to our proposals.
56. 374 firms perform only non-MiFID CPM activity, and do not hold MiFID IPM permissions. These firms are not therefore directly impacted by MiFID II changes in this area and are only affected due to our decision to extend these requirements. Combined with the 74 firms who do not intend to level up anyway, this provides a population of 448 firms who we envisage could incur direct material costs from our discretionary policy decision.
57. However, a proportion of firms who carry out CPM activity currently delegate the investment management of their funds entirely to another firm (or firms), in which case the delegated mandate is regulated as IPM activity subject to MiFID requirements. This means, assuming such firms continue this approach in future, they would benefit from the MiFID II requirements being applied by the firm to which they delegate the management of their collective portfolios without incurring any direct cost themselves.
58. For the purposes of this CBA we have calculated a range of between 33-76% of firms carrying out CPM activity that do not delegate 100% of the investment management of their collective portfolios to a third party, which we have estimated based on answers to several CBA survey questions. We will apply this range to the 448 firms we identified who may face material costs from our decision. For the proportion that delegate entirely, eg between 66-24% of firms, we believe the CPM firm itself will not incur any direct costs from our discretionary decision to extend the MiFID II inducements reforms.
59. In light of this, the cost impacts of extending the MiFID II requirements on inducements and research to CPM activity are likely to be material for a minority of CPM firms.
60. The size of firms in this sector also varies widely. However, we do not believe applying these standards will unduly impact smaller versus larger firms. The MiFID II requirements on how firms can purchase research includes flexibility, such that firms can opt to either pass research

costs onto clients, with some additional oversight requirements, or pay for research directly, which removes the need for enhanced oversight.

61. Even if a firm seeks to pass costs on to clients and hence incur some compliance costs, these are likely to be proportionate to the size of firm – eg smaller firms who have fewer funds, strategies and / or individual staff to consult when setting budgets, establishing their research needs and disclosing costs to clients, are likely to face lower costs than a large firm with more complex operations. As set out below, given the costs that firms are already likely to incur under our dealing commission rules, we do not believe the incremental costs will be overly burdensome.

#### **Compliance costs**

62. Compliance costs on firms from extending MiFID II requirements to CPM business are difficult to estimate due to the options within MiFID II as to how a firm may choose to pay for research going forward. Some firms also said initial uncertainty as to the precise legal interpretation of aspects of the requirements created uncertainty as to the levels of compliance costs likely to be incurred. While we sought figures from a large sample of firms, supplemented by a second round of surveys, the level of returns with any estimated figures has been relatively small. Nonetheless, we have used figures provided from 23 firms to formulate the below estimates of potential costs where relevant.
63. In figures cited below, we have assumed that *all* firms will seek to use a form of research payment account (RPA), since this will be the costliest option in terms of compliance. While a sizeable number of firms may choose the alternative option of paying for research from their own resources, and so would not need to meet the more onerous requirements related to establishing a separate client research charge and using an RPA, we do not have reliable figures on what proportion this would be.
64. For those firms that chose to pay for research out of their own resources, any compliance and IT costs are likely to be lower than those described below. One-off costs in such cases are likely to involve re-negotiating broker execution rates and communications with clients to inform them of changes to costs incurred by their funds, and any corresponding negotiations to increase management fees if the firm seeks to pass on some of these research costs previously paid for in transaction costs passed to collective portfolios. The firm may also need to review their broker and research provider lists generally.
65. However making direct payments is likely to involve less compliance resources and IT to manage charge deductions from clients and remove the need to provide disclosures linked to the RPA as required by MiFID II. We have therefore been conservative in assuming all firms will use the RPA model, meaning the total costs for firms is likely to be an over-estimate once some firms adopting direct payments are taken into account.

#### **One-off costs**

*Firms carrying out IPM and CPM and intending to level up*

66. We consider that for the 598 firms already carrying out IPM business alongside CPM activity, many would extend the MiFID II standards to their CPM business voluntarily regardless of our discretionary decision, as such there will be costs of minimal significance resulting from our policy proposals.
67. Even if some of the firms we assume intend to level up may not have do so, we assess that any one off costs from extending MiFID II standards to their CPM business would be of minimal significance if made alongside the changes required to systems and processes changes for their MiFID II business. Most of these firms told us their use of research and commission management systems are currently integrated across their IPM and CPM activities, meaning the upgrades to

meet MiFID II standards for their IPM business would largely read across to their CPM activity with marginal additional changes potentially needed purely for their CPM business.

*CPM-only firms and firms carrying out IPM and CPM not intending to level up*

- 68.** 374 firms have permissions for CPM but not IPM, and 74 firms carry out IPM and CPM but do not intend to apply the MiFID II standards to their CPM business (448 firms in total), we know that a number of firms fully delegate the investment management to a MiFID firm. In this case, we assume a negligible one-off cost if the firm continues to delegate entirely, the management of their fund(s) will receive the benefit of MiFID II standards in this area with costs of minimal significance to themselves.<sup>78</sup>
- 69.** For the proportion of the 448 firms who do not delegate all of the investment management activity, for which we have estimated a range of 33-76% of firms, they will incur costs from our discretionary proposals to require firms undertaking CPM activity to meet the MiFID II standard in this area.
- 70.** We have estimated potential one-off costs based on data provided to us as part of the MiFID II CBA survey. From this data, we estimate an average one-off cost for individual firms of £36,000. When combined with the firm population of 448 and accounting for our estimated range of firms who may delegate in full the management of its collective portfolios, we have calculated total one-off costs as a range between a lower estimate of £5.4m and a higher estimate of £12.1m.
- 71.** Few firms provided any detailed breakdown or justification for what changes these costs will cover. However, based on our own analysis of the MiFID II requirements, we assume one-off costs would primarily include:
- Revising internal governance and policies for establishing a research budget (although we expect most firms to already have some form of budget and process in place under our current rules), setting up governance and systems to enable ongoing assessments of the eligibility of research and the quality of services to be received in line with new MiFID II standards and scope, and undertaking a review of existing providers. This may involve upgrades to IT systems to ensure the firm can adequately track and review research usage and quality for this purpose.
  - Converting existing in-house systems or updating third party outsourced arrangements to enable the firm to deduct separate research charges from portfolios (either directly from portfolios or alongside transactions) to meet the new RPA requirements and extend this approach across all financial instruments. This will include processes to accrue deductions into a research payment account, and monitor this in line with a pre-set budget. The RPA system will also need to facilitate payments to third party research providers, and record an audit trail of payments.
  - Establishing a written research policy, replacing initial disclosures on use of dealing commission arrangements, and a new template for periodic cost disclosures for research (although we propose to modify this requirement for internally managed AIFs), which will require more detail on what research providers have been paid for compared to current practices (eg the Investment Association's model 'Level 2' disclosures used by most firms to disclose current dealing commission costs).

<sup>78</sup> For these firms, we assume they already have processes in place to regularly review their outsourcing arrangements including a periodic review of the terms of their arrangements and performance, which we would expect under our rules. This means any review of the third party they use to delegate the investment management to and their terms and conditions would not pose additional costs but be absorbed into their existing baseline costs.

**Ongoing costs**

*Firms carrying out IPM and CPM and intending to level up*

- 72.** Consistent with our analysis above, we assume zero ongoing costs for the 598 firms carrying out both IPM and CPM activity and who already intended to adopt the MiFID II standards on inducements and research to their CPM business, since taking this as our baseline there are costs of minimal significance created by our discretionary decision.

*CPM-only firms and firms carrying out IPM and CPM not intending to level up*

- 73.** For ongoing costs, our broad analysis of the impact is similar to the above for this sub-set of 448 firms. We assume material costs for the range of 33-76% of firms who do not delegate all of the investment management of their collective portfolios to third parties. Conversely, for those that do delegate 100%, we assume zero direct costs.

- 74.** Based on the same survey from 23 firms referenced above, we estimate an average ongoing cost for an individual firm of £19,000. Based on the same methodology, using the firm population of 448 and the range of possible delegation of all management activity, we calculate a range of total ongoing costs of between £2.9m and £6.5m.<sup>79</sup>

- 75.** Again, with respect to ongoing costs for CPM firms, few survey responses gave any description in response to the survey of what specific processes or requirements caused the ongoing costs firms stated to us. However, ongoing costs of managing collective portfolios entirely in-house are likely to be lower once one-off changes to disclosure templates, and policies and procedures are in place. We suggest the main ongoing costs will most likely stem from:

- additional IT systems maintenance and reconciliations of client research charges, above current costs of commission management tools, for the new RPAs
- reviewing research policy and governance on at least annual basis, including the amount of the research budget set for each relevant group of portfolios<sup>80</sup>
- providing enhanced ongoing periodic disclosures to CPM clients compared to current dealing commission disclosures
- regularly reviewing research provider quality and performance in more detail than firms may perform under current rules

- 76.** The level of additional ongoing costs could vary quite widely from firm to firm depending on their current approach to assessing third party research under our dealing commission rules. CPM firms who currently adopt best practices in robustly assessing and valuing research paid for with dealing commission are likely to incur lower additional ongoing costs from adapting processes to meet the MiFID II standard given it mandates greater ongoing rigour and accountability for spending on third party research.

- 77.** As noted above, our cost estimates also assume firms choose to make use of an RPA approach. If firms choose to pay for research directly, they would not have to provide periodic disclosures to clients, review research policies, or ring-fence and monitor separate RPAs. In such cases, the implementation costs, especially for CPM-only firms, are likely to be much lower. Our figures are therefore likely to be an over-estimate of the total one-off and ongoing costs.

<sup>79</sup> We excluded two figures for ongoing costs that appeared to be significant outliers, and would have made the ongoing costs more than treble this estimate.

<sup>80</sup> This estimate only seeks to identify marginal additional costs that may arise under MiFID II standards compared to current periodic reviews we would expect firms to undertake on their dealing commission arrangements and processes to ensure they purchase research and use commissions in the best interests of their clients.



**Wider impacts**

- 78.** It is likely that other EU member states will not choose to apply the MiFID II standards in this area to firms carrying out CPM. Since funds can be passported and marketed across the EU under both the UCITS Directive and (for professional investors) AIFMD, this will initially create some competitive distortion for UK funds versus EU counterparts. However, we think the net benefit outweighs this risk, and that over time the impact of the reforms should make UK funds more transparent and better value for money. There is also the possibility that subsequent revisions to the UCITS Directive and AIFMD may harmonise standards, meaning any differences may be temporary and at that stage UK fund managers would already meet the requirements and not need to make changes.

**Benefits**

- 79.** Extending MiFID II rules on inducements to CPM of funds or collective investment schemes will result in improvements in the quality of research and avoid firms overbuying research.
- 80.** Investment Association figures indicate that £1,023bn was invested in UK-domiciled funds at the end of 2015, with £551bn of underlying funds in equities, although around 12-13% of this represents passive equity tracker funds for which research costs will not be incurred.<sup>81</sup> Assuming a figure of £480bn invested in equities in authorised funds managed on an active basis, if applying MiFID II reforms to CPM firms produced a further 1 bps of cost savings as a proportion of AuM due to the greater oversight and control by investment managers over spending on research in their CPM business compared to dealing commission costs incurred for research under current UK market practices, this could lead to £48 million per annum in reduced costs for investors.<sup>82</sup>
- 81.** For fixed income and other asset classes, costs versus benefits may be broadly cost-neutral in the short term. This is because separate payments for research on fixed income may offset out any potential reduction in transaction costs passed to clients, or with any net difference likely to be very small.
- 82.** The new regime on research procurement will also remove the potential inducement and conflicts of interest for firms carrying out CPM over where they execute orders or purchase research. By ensuring firms' trading decisions are separated from and not influenced by their receipt of research from brokers, this could encourage CPM firms to make further improvements in execution quality and costs to the benefit of investors. They may also buy better quality research that more directly informs their investment decisions on behalf of clients. Both effects are likely to be positive, although we have not tried to quantify them.
- 83.** We also believe that the new MiFID II regime for receiving research will encourage a more competitive market for research by separating out payments for research from execution services. This will allow independent research providers to compete more easily with brokers, who will no longer be able to bundle research on an unpriced basis with execution, and provide greater choice and specialisation in the market. This should benefit firms carrying out CPM in the same way as IPM business.

<sup>81</sup> Figures based on IMA Fund Statistics for December 2015, see: <http://www.theinvestmentassociation.org/fund-statistics>

<sup>82</sup> Estimate based on a combination of IA figures and estimates from our internal data. This estimate reflects a very broad brush calculation, due to the difficulty of identifying amounts spent through dealing commissions on research and further segregating this for collective portfolio management activity only. Our data does not provide a precise break down between investment managers' IPM and CPM activities. Since many firms will execute orders and consume research on an aggregated basis across both individual and collective portfolios / funds, it is unlikely any data could provide figures for existing spending through dealing commission on research purely for funds activity and thereby indicate more precisely possible savings.

## Client categorisation

### Local Authorities

#### Introduction

84. As set out in the chapter 4, we propose the following discretionary amendments arising from MiFID II in relation to the client categorisation of local authorities<sup>83</sup>:
85. Amending the criteria by which local authorities can opt-up to professional client status by increasing the portfolio size requirement under limb (b) of COBS 3.5.3R (2) from €500,000 to £15 million, and rendering this requirement mandatory.
86. Where a local authority acts in the capacity as the administrator of a pension scheme<sup>84</sup> as well as in its principal (treasury management) capacity, to apply the revised opt-up criteria **separately** to the pension scheme and principal (treasury) functions (meaning that the local authority must be able to opt up independently for each function).
87. Extend the default retail categorisation of local authorities to non-MiFID scope business<sup>85</sup> (subject to the same revised opt-up criteria).
88. The firms affected by these policies include:
- Firms (brokers, banks, investment managers) providing investment services to local authorities. These proposals also apply to the branches of third country firms.
  - For the purposes of this note, ‘treasury management’ refers to activities of local authorities relating to the management of public funds required for the fulfilment of their statutory duties (eg local waste management and collection, social housing, social services). The reference to “Local authorities acting in their capacity as the administrator of a pension scheme” relates to a separate activity of managing the pension funds of local authority staff.

#### Rationale for intervention

89. The financial crisis saw local authorities and municipalities suffering significant losses because they were sold financial instruments which were inappropriate for their needs.<sup>86</sup> These issues arose in the UK in relation to interest-rate swaps<sup>87</sup> for example. This has demonstrated the vulnerability of many UK Local Authorities when faced with decisions to invest in financial products.
90. There are two main conditions that may lead to consumer detriment:
- information asymmetry, whereby local authorities may not always hold sufficient information or expertise to adequately understand and assess investment risks, and

83 As set out in the CP chapter, the definition of “local authority” will determine the size of the entities to be considered by this policy. For the purposes of this analysis, we adopt DCLG’s ‘E-code’ definition of local authority, which identifies 518 local authorities. See <https://www.gov.uk/government/statistical-data-sets/live-tables-on-local-government-finance#borrowing-and-investment>.

84 This refers to the management of the pension funds of local authority staff members.

85 With the exception of Article 3 firms (independent financial advisors, corporate finance boutique firms and venture capital firms). These are considered to fall outside of the scope of MiFID business since they are optionally-exempt entities under Article 3 of MiFID.

86 The European Commission MiFID II Framework Directive impact assessment (2011) highlights the risk of inappropriate categorisation of local authorities, citing a number of alleged cases of mis-selling of derivatives and other complex products involving municipalities. See page 17: [http://ec.europa.eu/internal\\_market/securities/docs/isd/mifid/SEC\\_2011\\_1226\\_en.pdf](http://ec.europa.eu/internal_market/securities/docs/isd/mifid/SEC_2011_1226_en.pdf).

87 In previous years local authorities were banned from investing in derivative products due to significant losses suffered by Hammersmith & Fulham Council and subsequent legal action, but this restriction has subsequently been lifted. In addition, banks are able to effectively enter into derivative contracts with councils through the use of LOBOs (Lender Option Buyer Option) loans.



- ‘regulatory avoidance’, whereby investment firms may have incentive to treat local authorities as professional clients in order to avoid applying the more onerous retail client protection standards or to sell more complex products with higher returns.

91. The specific rationale for each policy area is as follows:

- Increasing the quantitative threshold for opting-up
  - It is essential to distinguish between sophisticated and non-sophisticated local authorities<sup>88</sup>, to ensure that only those which have the necessary knowledge, experience and expertise can opt-up to professional client status, foregoing the regulatory protections afforded only to retail clients. The size of a local authority’s financial instrument portfolio (including cash deposits) is used as a proxy measure of the client’s knowledge, experience and expertise<sup>89</sup>. We believe that those local authorities that have portfolio sizes in excess of £15 million are likely to have the necessary skills and knowledge so as not to require the same regulatory protections given to smaller local authorities<sup>90</sup>.
- Applying the opt-up criteria separately to the treasury and pension fund administration capacities of local authorities
  - Local authorities acting in their capacity as the administrator of a pension scheme as well as in their principal capacity (ie treasury management) generally do so within the same legal entity, even though the two functions are managed separately. By virtue of the scale of the pension fund assets managed by local authorities which also administer pension funds (referred to as Local Government Pension Scheme administering entities<sup>91</sup>), all of these local authorities would be likely to automatically satisfy the quantitative test if we applied the opt-up criteria to the entity as a whole (even if the treasury functions considered alone fell far below the minimum threshold). Applying the criteria separately will ensure that small treasury functions, regardless of whether their local authorities also administer a pension scheme, remain categorised as retail clients with the associated protections.
- Extending MiFID II changes to non-MiFID scope business
  - We also propose to extend the retail categorisation, and the corresponding discretionary opt-up criteria, to non-MiFID scope business. This is because similar risks apply to MiFID-scope business as to non-MiFID scope business. This will help to avoid any potential regulatory gaps or avoidance, and will ensure that local authority clients are adequately protected by retail investor protections for all of the business they conduct.

### Baseline for analysis

92. The baseline for our analysis of the policy proposals is as follows:

- *Revised quantitative opt-up criteria for local authorities in relation to MiFID scope business:* the baseline is the *current situation* whereby Local authorities are categorised as per se

88 In the UK, the approximate portfolio sizes of local authorities imply that almost all would exceed the €500,000 threshold (around 97 per cent). The portfolio size requirement under MiFID II applies to a wide range of entities, not only local authorities/ municipalities. Further, the portfolio size requirement in COBS 3.5.3R (2) was devised primarily with high-net worth clients in mind.

89 This is because, for example, larger local authorities are more likely to have in-house investment advisers and have adequate resources to pay for financial advice. Using size as a proxy for sophistication is one of the underlying assumptions of MiFID’s client categorisation regime.

90 The FCA understands that smaller local authorities tend to have portfolio sizes of approximately £10,000,000.

91 These are administering entities of the Local Government Pension Scheme. Assets under Management are approximately £150 billion across 89 administering entities.

professional clients if they meet the MiFID Large Undertaking test in COBS 3.5.2R (2) or, if they do not, they are retail clients, but can be opted-up to elective professional status if they meet the criteria in COBS 3.5.3R.

- *Separately applying the opt-up criteria to the pension scheme administration and treasury functions within a local authority:* the baseline would be that, under MiFID II, the opt-up criteria would apply to the local authority as a whole<sup>92</sup>.
- *Extending the default retail client categorisation with the revised opt-up criteria to local authorities undertaking non-MiFID scope business:* the baseline is the current situation, namely that local authorities are considered as per se professional clients for non-MiFID scope business. However, investment firms servicing local authorities in relation to both MiFID and non-MiFID scope business ('mixed scope business') need to categorise these clients as retail clients for the purposes of complying with the mixed business rule in COBS 3.1.4R.<sup>93</sup> The baseline for such firms would therefore become the same as above, namely default retail categorisation with the MiFID II opt-up criteria.

### Costs

93. We begin our discussion of the costs of the policy proposals with the likely scale of impact across the different groups of firms, and then present the direct cost estimates.

#### *Likely scope of costs*

*Local authorities acting in their principle capacity (treasury management)*

94. The most significant impact of the revised quantitative opt-up criteria for MiFID scope business is that fewer local authorities would be able to opt-up to professional client status compared with the baseline situation. We estimate that out of a total of 518 local authorities with investments, 324 (around 63 per cent) have investments in MiFID scope instruments and are thus relevant to this policy.<sup>94</sup> Of these, all but one have total portfolio sizes greater than €500,000 and thus would be able to opt-up to professional client status in the baseline situation (provided they met the qualitative criteria). However, only 261 out of 518 have total portfolio sizes greater than or equal to £15 million. The policy therefore implies that 63 additional local authorities would not be able to opt-up to professional client status for the purposes of engaging in MiFID business as a result of our policy, compared to the baseline situation.

*For all local authorities (ie acting as treasury managers or pension fund administrators)*

There are 89 local government pension scheme administering entities in England and Wales. Most of these are administered by local authorities, but not all. However, if we take this as the maximum possible number of local authorities that may be acting in their capacity as a pension scheme administrator, then there could potentially be around 89 local authorities (and their associated investment firms) impacted by our policy to separately apply the opt-up criteria to pension scheme administrator functions and treasury functions. Official figures reveal that the 89 local government pension scheme administering entities collectively manage assets of around £181 billion. As such, although such local authorities will need to consider the revised

92 The fact that pension fund administration functions and treasury management functions are carried out within the same entity (ie local authority) appears to be a UK-specific structure.

93 Our Handbook currently states that for mixed-scope firms MiFID client categorisation rules prevail. These Handbook rules will remain the same (essentially reinforcing our discretionary policy to mandate the extension of MiFID II client categorisation to non-MiFID business). It is therefore not clear the extent to which mixed-scope firms will apply the MiFID II client categorisation rules to non-MiFID business voluntarily, or because of our rules.

94 Source: Department for Communities and Local Government, Statistical dataset, Live tables on local government finance, "Borrowing and Investment table" <https://www.gov.uk/government/statistical-data-sets/live-tables-on-local-government-finance#borrowing-and-investment>

95 Relevant MiFID Instruments include for example corporate and sovereign bonds, money market funds, certificates of deposits, and treasury bills.

threshold, it is not expected that any will be unable to meet the quantitative criteria in order to opt-up to professional client status, notwithstanding that they will be automatically classified as retail clients by virtue of the wording of MiFID II (Annex II (2)).

***Extending MiFID II changes to non-MiFID scope business***

95. The general impact of the policy option to extend the default retail categorisation and revised opt-up criteria for non-MiFID scope business is that investment firms would also need to categorise these local authorities as retail clients in relation to any non-MiFID scope business provided; and then continue to treat those unable to opt up to professional status as retail clients. However, we estimate that only a small number of local authorities currently invest in non-MiFID Instruments<sup>96</sup> or are serviced by non-MiFID firms. Of these, we understand that the vast majority have portfolios large enough to opt up to professional status under our proposed new criteria<sup>97</sup>. Further, the majority of firms servicing these local authorities are likely to provide both MiFID and non-MiFID scope business, and therefore would need to undertake the re-categorisation and opt-up procedures for MiFID business in any event to comply with MiFID II.<sup>98</sup> The mixed business rule in COBS 3.1.4 would also apply in this context.

***Direct costs to investment firms***

96. Whilst our proposed policy would not involve investment firms incurring additional costs of re-categorising all of their local authority clients as retail clients in relation to MiFID business,<sup>99</sup> they would potentially incur costs of dealing with a greater number of local authorities as retail clients, compared to the baseline situation. This could include one-off costs such as staff training in dealing with retail clients, client communication, compliance and legal procedures. To the extent that affected firms do not have retail permissions, they would also incur the cost of applying for such permission<sup>100</sup> if they chose to continue servicing local authorities categorised as retail clients.
97. Investment firms may also incur ongoing costs of treating a greater number of local authorities as retail rather than professional clients, eg time spent verifying that local authorities fully understand investment risks and conducting suitability and appropriateness tests on certain products.
98. However, the magnitude of these costs is likely to be small. Only a small proportion of local authorities would be unable to opt-up to professional status under our proposed quantitative criteria as revised (we estimate around 63) and it is likely that these are currently served by only a few investment firms. It is also likely that many of these firms would have other retail clients and thus would already have in place the necessary procedures to deal with those retail clients. In the event that any of the affected firms do not have other retail clients, they would potentially incur additional costs of implementing retail procedures, including obtaining retail permissions.

96 The majority of local authorities' investment is not in designated investment business, for example bank and building society deposits, which fall outside of the scope of all policies discussed here.

97 Publicly available data from the Department of Communities and Local Government does not include data in respect of town and parish councils.

98 The vast majority of the local authorities engaged in non-MiFID designated investment business are also engaged in MiFID business.

99 The requirement to automatically categorise local authorities as retail clients for MiFID business is part of MiFID II requirements, and not our discretionary policy.

100 Direct costs in this respect would be minimal with firms being required to pay an application fee of £250.

99. We estimate that<sup>101</sup> the one-off costs to investment firms could be in the region of £1.7 million. On-going costs are estimated in the order of £750,000.<sup>102</sup> These cost estimates assume that the affected firms already have retail clients and thus the relevant procedures are already in place. If these investment firms do not have any retail clients, then the costs of adopting all the necessary retail procedures – for example, retail permissions, suitability and appropriateness tests etc. – could be higher (one large firm quoted a cost of around £300,000 for implementing such procedures across its business). In the face of these costs, we would expect the firm to no longer service the local authority classified as a retail client, rather than incur the costs.
100. The costs to investment firms of applying the opt-up criteria separately to the treasury and pension administration functions of local authorities are not likely to be material, but would involve some additional administration time spent reviewing any additional applications. For example, the cost of time spent checking which local authority function the firm is dealing with, or communicating the requirement to apply the opt-up criteria separately to the local authority.
101. The costs to firms of extending the retail categorisation and revised opt-up criteria to local authorities for the purposes of non-MiFID scope business will depend on the nature of the firm. For firms that provide both MiFID and non-MiFID scope business, we assume that they would adopt the same categorisation procedure for both types of business, and therefore that the costs of extending the requirements to non-MiFID scope business would not be material. The majority of respondents to our survey that provide services in non-MiFID scope business also provide MiFID scope business. Where firms only provide non-MiFID scope business, incremental costs would be greater. We estimate one-off and annual ongoing costs of £770,000 and £350,000 respectively<sup>103</sup>, relating to categorising local authorities as retail clients, including compliance and legal costs, and treating them as such.<sup>104</sup> However, these costs represent a notable upper-bound, as we consider it unlikely that this many firms would be providing non-MiFID services only and would need to deal with local authorities which are ineligible to opt up to professional client status.

***Direct costs to local authorities***

102. For the first policy proposal (ie the revised quantitative criteria), fewer local authorities would be able to opt-up to professional status compared to the baseline situation. The costs to local authorities of being treated as a retail client rather than a professional client could be driven by having restricted access to the more sophisticated parts of financial markets, for example being treated differently by counterparties and subject to higher transaction costs, for example. Such costs could fall across all local authorities that can no longer be classified as per se professional clients or opt up to professional client status. While the reclassification would not by necessity mean that certain more complex or higher risk financial products were not available to these local authorities, this is a potentially foreseeable effect (eg because it may not be within the risk appetite of some firms to provide more complicated products to retail clients).
103. For the second policy proposal (separate application of the opt-up criteria to treasury and pension fund administration functions respectively), local authorities may incur higher

101 Cost information from our survey is very uncertain, due to a range of assumptions used by respondents which were not always aligned with the policy.

102 This is based on an estimated average cost of £25,000 per firm. The aggregated estimate is heavily dependent on the number of firms affected (ie those serving local authorities that would not be able to opt up). The figure we present represents a maximum because we have assumed each of the 63 affected local authorities is served by a different firm – whereas in reality it is likely that they are serviced by a much smaller number of firms. We assume that all these firms would have retail clients and thus would have retail procedures already in place.

103 Please note that the estimated costs to firms providing only non-MiFID scope business to Local authorities is based on estimated costs provided by both firms providing MiFID scope and non-MiFID scope business to Local authorities because we received very few responses from firms who provide only non-MiFID business to Local authority

104 Again, the figures we present represent a maximum because we assume each of the estimated 8 local authorities are served by different firms. Average one-off and ongoing costs per firm of approximately £95,000 and £45,000 respectively.

administrative costs as a result of having to apply the opt-up criteria separately to their treasury functions and pension administration functions (where relevant). However, as these functions are generally managed separately, separating out the opt-up process should result in costs of minimal significance.

- 104.** For the third policy option (extension to non-MiFID scope business), local authorities would only incur incremental costs if they solely engage in non-MiFID business (otherwise they would incur the retail categorisation and opt-up costs as part of MiFID II anyway). Our data shows that virtually no local authorities are investing solely in non-MiFID Instruments, and thus we do not expect these costs to materialise. Local authorities may be treated differently by different counterparties depending on their categorisation, and this distinction may apply to non-MiFID Instruments, in which case it would make a difference to the local authority if they were classified as, say, 'retail' for MiFID scope instruments and remain 'professional' for non-MiFID Instruments. Applying the MiFID II requirements across the board in this case may have wider impacts.

#### **Wider impacts**

- 105.** There is some risk that the new threshold portfolio size captures within the definition of 'retail' some local authorities that are in fact adequately skilled to operate as professional clients. A number of investment firms responding to our survey have indicated that the types of financial instruments that they make available to retail clients are significantly simplified and limited compared to those available to professional clients. In addition, counterparties may treat local authorities differently depending on whether they are retail or professional clients, eg offering less favourable terms for a particular transaction. As such, while local authorities who are unable to opt up to professional status will benefit from added regulatory protections<sup>105</sup>, they could potentially face more limited investment options which could negatively affect their ability to manage their funds or limit their hedging<sup>106</sup> abilities. Where local authorities are in fact qualified to act as professional clients, the revised criteria could bring about adverse wider impacts without the associated benefits.
- 106.** A particular issue is raised in the categorisation of local authorities acting in their capacity as pension scheme administrators. The intention of the revised threshold, however, is to enable **all** pension scheme administrators to opt up to professional status (based on our understanding of the size of these portfolios). However, if for any reason a pension scheme administrator's portfolio size is below the threshold, they could suffer particularly adverse consequences of being categorised as a retail client, such as being unable to hedge inflation and interest rate risks if they are restricted in, eg, the derivatives instruments they can access.
- 107.** Local authorities that cannot opt up to professional client status may no longer be served by certain investment firms, ie those that do not currently have retail permissions and for whom the costs of servicing retail clients may not be cost-effective. However, we assume that these affected local authorities would easily be able to find other investment firms to serve them as retail clients.

#### **Benefits**

- 108.** As a result of the higher quantitative threshold under the proposed policy, investment firms will now offer greater retail protections to a larger number of local authorities compared to the baseline (ie because fewer local authorities will be able to opt-up). The full spectrum of regulatory protections associated with retail client status will help local authorities to be better informed about the investments which they make by placing a higher level of responsibility on

<sup>105</sup> Compared with professional clients.

<sup>106</sup> For instance, if certain firms decide not to provide derivatives products such as future or options traditionally used for hedging purposes to retail clients.

the firms which are servicing them. Local authorities with portfolios in excess of £15million can be assumed to be more sophisticated than those with portfolios in excess of €500,000, subject to satisfying the qualitative criteria.

- 109.** This means that they are much less likely to invest in products which are not suited to their risk appetite/financial portfolio size. It will also help to avoid situations in which local authorities are opted-up to professional status inappropriately, without the knowledge or expertise to understand the risks attached to their investments – which often leads to detriment. Where local authorities are opted-up to elective professional client status, they will benefit from added protection because firms are required to monitor, on an on-going basis, whether or not elective professional clients (local authorities in this case) continue to satisfy the criteria which allowed them to opt-up to professional status in the first place. Furthermore, if a firm becomes aware that the client no longer meets the criteria, it must take appropriate action<sup>107</sup>. As a result of these added protections, pension fund assets and treasury reserves would be better protected from potential losses associated with the mis-selling of products which are unsuitable for the local authority.
- 110.** Quantifying the incremental benefits of our revised criteria is not reasonably practicable for a number of reasons, namely that it is not possible to know which local authorities that would be categorised as “retail” client would be those which otherwise would be exposed to detrimental investment risks if continuing to operate as “professional”. In addition, it is not possible to identify the extent to which prior losses involving local authorities were the result of a lack of retail protections on the part of investment firms, or other factors such as local authorities diverging from standard treasury management policies.<sup>108</sup>

### ***ECPs***

#### **Introduction**

- 111.** As set out in Chapter 4, the FCA is proposes to apply MiFID II’s changes in respect of opting up elective professional clients to elective eligible counterparty (ECP) status to non-MiFID scope business. This would mean:
- Removing the possibility for elective professional clients to opt-up to ECP status for non-MiFID scope business.
  - Introducing additional procedural notification requirements for opting-up clients to ECP status (which will only be available for per se professional clients) as follows:
    - Firms must provide clients with a clear written warning of the consequences for the client of such a request [ie a request to opt-up to ECP status], including the protections they may forego;
    - Clients must confirm in writing the request to be treated as an ECP and that they are aware of the consequences in respect of the protections they may lose further to such a request.
- 112.** However, we believe that this change would have a very limited market impact. Our firm survey indicates that fewer than two per cent of respondents have ever had occasion to opt-up elective professional clients to ECP status.
- 113.** The firms affected by this policy option include:

<sup>107</sup> See COBS 3.5.9R.

<sup>108</sup> For example, evidence given in a Treasury Select Committee hearing in relation to the impact of the failure of the Icelandic banks indicates that during the crisis some local authorities continued to invest in the banks in breach of treasury management policies.



- Firms providing investment services to ECPs or professional clients in relation to non-MiFID scope business<sup>109</sup> or non-MiFID scope instruments (such as insurance-based investment products or personal pensions). These would include discretionary investment managers, stockbrokers, corporate finance firms and banks, and
- Branches of third country firms.

### Rationale for intervention

**114.** The conduct of business rules and other protections applicable to retail and professional clients seek to address the potential consumer detriment that may arise from these clients tending to possess less information and knowledge about investment risks than other more sophisticated market participants (eg some of the firms which might provide them with investment services). Ultimately these rules aim to protect against the risk of these clients making inappropriate investment decisions and potentially suffering investment losses.

**115.** This risk may be particularly acute for elective professional clients who then opt-up to become elective eligible counterparties, without fully considering the consequences<sup>110</sup> – ie the disapplication of specific regulatory protections afforded exclusively to professional and retail clients, such as the obligation on firms to provide best execution. It is therefore essential that the FCA addresses such risks, which are of paramount importance to the protection of consumers.

**116.** We note that the current framework does not mandate any specific procedure to be followed by firms opting-up their clients from per se or elective professional status to the ECP category for non-MiFID scope business.<sup>111</sup> Such clients are presumed to possess the required market knowledge and experience<sup>112</sup> and are expected to understand the implications of re-categorisation in terms of the level of regulatory protection afforded to them. Requiring firms to provide their clients with an appropriate level of information, ensuring that they fully understand the type(s) of protection they are losing when opting-up from one category to another, as well as ensuring that clients explicitly confirm this change, will avoid the risks deriving from insufficient information as well as any uncertainty or lack of transparency around the opt-up process.

### Baseline for analysis

**117.** The relevant baselines against which we measure the additional impacts of the FCA's proposed policies are as follows:

- *Opting up elective professional clients for non-MiFID business:* Elective professional clients are currently able to opt up to ECP status for non-MiFID scope business. The new rules we intend to introduce will remove that possibility.
- *Procedural changes:* Currently, firms only need to receive confirmation from the client that it wishes to be treated as an ECP (for MiFID business, express confirmation is required). Under MiFID II, additional procedural notifications will be required for MiFID business (clear written warning to be provided by firms and written confirmation to be provided by clients being opted-up).

<sup>109</sup> These proposals will not apply to optionally exempt Article 3 firms (Independent Financial Advisors, Corporate Finance Boutique Firms and Venture Capital Firms).

<sup>110</sup> For example, in the course of its Best Execution thematic review, the FCA received feedback that investment firms can re-categorise clients to ECP status in order to avoid certain regulatory requirements (eg the obligation to provide best execution).

<sup>111</sup> In the case of MiFID business, the firm must obtain express confirmation from the client that it agrees to be treated as an eligible counterparty (see COBS 3.6.4R (2)). However, this does not need to include that they are aware of the consequences of the protections they may lose further to such a request.

<sup>112</sup> Notwithstanding the fact that elective professional clients cannot be presumed to possess the market knowledge and experience comparable to a per se professional client – see COBS 3.5.7G.

**Costs*****Likely scope of costs***

**118.** Our survey responses suggest that the practice of opting up elective professional clients to ECP status for non-MiFID scope business is very uncommon – less than two per cent of respondents said they had ever had occasion to do this.<sup>113</sup> Further, for those firms currently operating under MiFID scope, our conversations with industry suggest that these firms would, in general, apply the same approach to clients for both MiFID and non-MiFID scope instruments, and that any changes stemming from MiFID II would need to be applied across the board in any event<sup>114</sup>. Therefore, for a large proportion of the potentially affected population, it is unlikely that the FCA's discretionary policy would lead to material additional implementation costs over and above those which firms would incur anyway to comply with MiFID II.

**119.** This suggests that the overall impact of the FCA's discretionary policy in this area will not be material, and, as such, we have not undertaken a full quantification of the costs and benefits<sup>115</sup>. The FCA has spoken to both firms and trade associations to confirm our survey findings (ie that the facility for opting-up elective professional clients to ECP status is very uncommon) and these conversations confirm our analysis<sup>116</sup> in terms of the likely impact.

***Possible direct costs to investment firms***

**120.** For the few firms potentially affected by this proposed policy, the direct costs of no longer being able to opt-up from elective professional clients to ECP status for non-MiFID scope business might include:

- One-off costs of re-categorising all elective ECPs to professional client status such as policy development, legal and compliance activities, re-papering and client communication costs; and
- Ongoing costs of complying with the greater number of regulatory requirements for professional clients compared to the requirements for ECPs. These requirements will include best execution obligations, the rule on inducements and certain client order handling requirements.

**121.** The direct costs to firms with respect to the procedural notification requirements could include:

- one-off costs of updating client communication procedures (for example, including a comprehensive list of the regulatory protections clients would lose as ECPs), and
- on-going processing costs of providing clients opting-up to ECP status with more information, and waiting for written confirmation of their acceptance.

**122.** These additional costs are likely to be of minimal significance. As set out above, we do not expect the overall cost impact of this policy approach to be material across the industry.

***Direct costs to clients***

**123.** Clients unable to opt up to ECP status for non-MiFID scope business would incur minimal direct costs. These could include administration costs associated with being re-classified as a professional client from ECP status (ie for clients currently classified as ECPs but who were

<sup>113</sup> Two out of 120 respondents

<sup>114</sup> For firms carrying out both MiFID and non-MiFID scope business, the "mixed business" rule applies in COBS 3.1.4R.

<sup>115</sup> This is also in line with the findings of the European Commission's 2011 MiFID Impact assessment that the impact of changes to client categorisation in relation to ECP status would be negligible.  
See page 191 [http://ec.europa.eu/internal\\_market/securities/docs/isd/mifid/SEC\\_2011\\_1226\\_en.pdf](http://ec.europa.eu/internal_market/securities/docs/isd/mifid/SEC_2011_1226_en.pdf)

<sup>116</sup> For example, the FCA has spoken to the Investment Association and JP Morgan.



opted-up from elective professional client status). Again, to the extent that clients would need to undergo this review in any event as part of MiFID II for any MiFID scope business carried out, the incremental cost of compliance for non-MiFID business is unlikely to be material.

- 124.** Clients wishing to opt-up to ECP status would need to spend some additional time confirming in writing that they are aware of the consequences of the protections they may lose. As they already need to provide written consent when opting up, any costs associated with this are likely to be negligible.

#### **Wider impacts**

- 125.** The wider impacts of these proposals would be similar to those implied by the MiFID II requirements on the treatment of ECPs and the categorising of elective professional clients as ECPs.

- 126.** Elective professional clients unable to opt-up to ECP status could be subject to several impacts:

- The increased costs to investment firms of providing services may be passed on to them in the form of higher prices (ie because the firms providing them with services will have additional regulatory rules to comply with). The extent to which this would happen will depend on whether the clients can switch to firms with lower costs (eg those with already a large professional client base that would not experience many additional costs of treating more clients as professional rather than ECPs). However, firms which service ECPs generally also tend to service professional clients<sup>117</sup>. We therefore do not anticipate that this will be a significant impact.
- These clients might be less attractive as counterparties to trades and transactions because of the additional regulatory requirements which will apply (eg the obligation to provide best execution), thereby making transactions potentially slower and more costly.<sup>118</sup> This may lead to potential difficulties in finding counterparties to deal with. Again, however, most firms which deal with ECPs will also have a significant professional client base.

- 127.** The extent to which these potential indirect costs are outweighed by the increased protections they will receive as professional clients is unclear – but given the European Commission’s rationale for the policy ie that non-retail clients can have limited appreciation of investment risk, the benefits of protection are likely to outweigh the indirect costs.

#### **Benefits**

- 128.** The extension of the MiFID II requirements of removing the possibility of opting up elective professional clients to ECP status for non-MiFID scope business will ensure that clients are afforded the same type of regulatory protections irrespective of the type of financial instruments they are investing in or the types of investment service with which they are provided. This will avoid any regulatory arbitrage by firms seeking to circumvent certain regulatory protections through offering non-MiFID scope business in preference to MiFID scope business where such protections would apply.

- 129.** The increased protections applied to elective professional clients no longer classified as ECPs will help to address information asymmetries. Although it is not possible to quantify the detriment arising from elective professional clients inappropriately being treated as ECPs

<sup>117</sup> Particularly given that a client can only be classified as an eligible counterparty (ECP) for ECP business which is defined by a narrow subset of specific activities (eg dealing on own account).

<sup>118</sup> For example, when dealing with ECPs the lower regulatory requirements can imply quicker transaction times and a simpler contractual relationship (less reporting and paperwork to take into account, as well as fewer obligations and risks related to litigation, fiduciary duty, care etc.).

(as the scale of any opting up in practice appears to be very low), analysis conducted by the European Commission has shown that elective professional clients such as local authorities and corporates do not always possess sufficient knowledge to appreciate the risks attached to all of the investments they are making. With fewer regulatory protections provided to ECPs, it is not unreasonable to assume a high risk of potential detriment which this policy would help to mitigate for non-MiFID scope business.

- 130.** Similarly, the benefits of the procedural notification requirements will stem from ensuring that clients are not opted-up to ECP status without being fully aware of the protections they will lose, and that opting up only occurs with clients for whom it is appropriate. We expect that, given the additional transparency of the opting up procedure, some per se professional clients who would have opted up under the previous regulatory framework will now elect to remain in their existing category. In such cases, they would benefit from retaining regulatory protections afforded to professional clients and not to ECPs, as noted above.

## Disclosure requirements

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### Introduction

- 131.** MiFID II improves the requirements applying to firms in relation to the information they must provide clients, in particular non-retail clients. MiFID II also introduces improved costs and charges disclosure requirements, and some minor additional requirements relating to cross-selling products or services, post-sale reporting and record-keeping.
- 132.** In addition, in certain areas, MiFID II requires Member States to implement an ‘analogous’ record keeping regime – in line with the new requirements – for Article 3 firms. Article 3 firms primarily consist of retail financial advisers, corporate finance boutiques, and a small number of venture capital firms. Where required, we intend to apply the relevant revised MiFID II disclosure requirements to Article 3 firms.
- 133.** In order to ensure consumer protection, and consistency with the EU principle that third country firms should be treated ‘no more favourably’ than Union firms, we propose applying the new requirements to third country firms as well as MiFID investment firms.
- 134.** This is an area where it is intended that there is a common approach across the EU and therefore we have little or no margin for discretion in implementing MiFID II disclosure provisions. We therefore provide a high-level cost benefit analysis for firms acting within MiFID scope, for firms undertaking equivalent third-country business and for firms distributing MiFID products under the Article 3 exemption.
- 135.** When implementing or reflecting the MiFID II provisions in the FCA Handbook, we have sought to avoid exercising discretion and applying them to firms doing non-MiFID business (with the exception of Article 3 firms). However, where the recast provisions are identical to, very similar to, or can be inferred from, existing provisions in the Handbook, we have proposed to amend some rules relevant to non-MiFID business so they are consistent with the provisions applying in relation to MiFID business.

### Rationale for intervention

- 136.** As explained in Chapter 5, the amended disclosure requirements consulted on are designed to ensure appropriate investor protection, provide information to clients and potential clients, and provide for reporting to clients.

137. The improved requirements will promote common disclosures at a European Level. They will help competent authorities to more effectively and consistently undertake their supervisory work where financial instruments are marketed and sold across jurisdictions.

#### **Baseline for analysis**

138. UK branches of third country firms and Article 3 firms, are already subject to the FCA's disclosure requirements, based on MiFID. These requirements are therefore the baseline for our analysis in respect of the enhanced MiFID II provisions.

#### **Costs**

139. We begin our discussion of the disclosure policy proposals with a view on the likely scale of impact across the different types of firm, and then present our analysis of the costs.

#### ***Likely scope of costs***

140. The direct cost of applying the revised, non-discretionary MiFID II disclosure requirements to firms doing MiFID or equivalent third country business, and Article 3 firms, is likely to vary, depending on the extent firms do business with clients who will be considered professional clients or ECPs. However, the new MiFID II requirements will require extensions or updates to the existing disclosure procedures of such firms, whatever their business model.

141. As only minor changes are being proposed in relation to the disclosure requirements apply to firms doing non-MiFID business, it is our view that the discretionary application of the provisions proposed will have a negligible impact on the industry, with costs of minimal significance.

#### ***Direct costs to firms doing MiFID business***

142. One-off costs for firms doing MiFID or equivalent third country business (and Article 3 firms) will include costs for: staff training, legal costs, compliance costs, and the cost of updating disclosure processes. However, for most firms, we do not consider the on-going costs of complying with the revised disclosure requirements, by providing more detailed information, to be significantly different from the on-going costs of complying with the existing disclosure rules.

143. We expect firms, that offer investment products and services, for which there are complex costs and charges arrangements in place, and firms with a significant number of professional clients, to incur the most additional costs. These firms will need to provide their clients with more information than previously. Further, given the changes proposed in relation to client categorisation, more firms will be affected by increased disclosure costs than would have been the case if the client categorisation rules had stayed the same. For example, firms will now face additional costs if they have clients, who would have been categorised as professional clients but will now need to be considered retail clients, or clients, who would have been ECPs but will now need to be considered professional clients.

#### ***Direct costs to firms doing non-MiFID business***

144. One-off costs for firms doing non-MiFID business may include costs for: staff training, legal costs, compliance costs, and the cost of updating disclosure processes. However, as we are not altering the effect of the rules applying to these firms, we expect that these one-off costs will have a negligible impact on the industry, and result costs of minimal significance.

145. Since changes proposed in relation to the client categorisation rules are to apply in relation to non-MiFID scope business, a small number of non-MiFID firms may incur additional disclosure costs, because they will need to provide more information to their clients. This will be the case if they have Local Authority clients, who would have been professional clients but will now need to be considered retail clients, or who would have been ECPs but will now need to be considered professional clients. As explained in the CBA section considering the changes to

the client categorisation rules, we expect these changes to have only limited impact on the non-MiFID market, and result in costs of minimal significance.

### Benefits

- 146.** As mentioned above, MiFID II enhances the disclosure material provided to professional clients, the applicable costs and charges disclosure requirements, and adds some minor requirements relating to cross-selling products or services, post-sale reporting and record-keeping.
- 147.** Calculating these benefits is not reasonably practicable because the benefits stemming from firms needing to provide additional information will vary depending on the product or service the information relates to, and the use the client makes of the information received. Examples of the benefits the new disclosure requirements may provide include:
- benefits arising from common disclosure standards applying across the EEA, facilitating easier cross-border activities;
  - the potential for better investment decision-making by Local Authorities, indirectly benefitting tax payers;
  - benefits arising from an improved awareness, by the FCA and industry stakeholders, of the costs and charges applying in the market that may lead to better regulatory decisions and more effective competition in the market, which will indirectly benefit consumers.
- 148.** If clients are better informed about the costs and charges applying to them, their options, and the investment risks involved, so that they make better investment decisions and avoid unsuitable investments, then the benefits of improved disclosure are likely to outweigh the costs.
- 149.** In relation the proposal to exempt firms doing non-MiFID business from the need to provide clients with periodic statements, so long as their clients can, and do, access their statements via online systems, we consider that this may result in minimal savings for firms.

## Independence

### Introduction

- 150.** The policy option being proposed is to implement MiFID II's standard in relation to independent advice. This will mean a move away from our current definition of 'independent advice', whereby firms' recommendations must be based on a comprehensive and fair analysis of the retail investment products (RIPs)<sup>119</sup> comprising their 'relevant market', to MiFID II's definition, whereby firms must assess a sufficient range of financial instruments which must be sufficiently diverse with regard to their type and product providers to ensure the client's objectives can be suitably met. This will apply to MiFID financial instruments, structured deposits and non-MiFID RIPs for retail clients.
- 151.** To help clarify our expectations about the range of products that should be considered, we are proposing to provide guidance confirming that since the assessment conducted by an independent firm must ensure that the client's objectives can be suitably met, a firm providing

<sup>119</sup> RIPs are (a) a life policy; or (b) a unit; or (c) a stakeholder pension scheme (including a group stakeholder pension scheme); or (d) a personal pension scheme (including a group personal pension scheme); or (e) an interest in an investment trust savings scheme; or (f) a security in an investment trust; or (g) any other designated investment which offers exposure to underlying financial assets, in a packaged form which modifies that exposure when compared with a direct holding in the financial asset; or (h) a structured capital-at-risk product; whether or not any of (a) to (h) are held within an ISA or a CTF.

independent advice should be in a position to advise on all product types within the scope of the market on which it provides advice.

**152.** In addition to structured deposits, MiFID II's independence standards will also apply to firms providing advice on shares, bonds and derivatives, ie firms wishing to hold themselves out as independent in respect of these products will need to comply with the new requirements. This is a matter where it is intended that there is a common approach across the EU and therefore we have little or no margin for discretion in implementing MiFID II.

**153.** The firms potentially affected by these proposals will be those providing financial advice to retail clients and professional clients, both on an independent and restricted basis as currently defined by us.

#### **Rationale for the policy proposal**

**154.** MiFID II's definition of independent implies that some firms may consider a potentially narrower range of products than currently and still hold themselves out as independent. However, we do not consider that moving to this standard would materially affect the practical impact of the current independence definition and would not have negative consequences for consumer protection – this is discussed in more detail in the CP chapter 6, see paras 6.21 to 6.27.

#### **Baseline for analysis**

**155.** The baseline for the analysis is our current independence standard, introduced with the RDR at the end of 2012. The incremental changes implied by MiFID II's standard are set out in the introduction to this section.

#### **Costs to firms**

**156.** We consider that the "discretionary changes" (ie those which we are proposing alongside those we are required to make by MiFID) will lead to costs of minimal significance imposed on firms. This is because we believe that where we are proposing to apply MiFID's independence standards to areas which fall outside of MiFID's scope, the differences between the new requirements and the current FCA requirements are minimal.

**157.** Chapter 6 explains how there are a small number of aspects of the MiFID II delegated regulation requirements which we are proposing not to read across to non MiFID business. These are where the detailed obligations are not currently reflected in similar rules and guidance currently. Where this is the case, we are not proposing to apply them to advice which falls outside of MiFID II so as to avoid disproportionate additional costs for industry. This includes, amongst other requirements, the prohibition on a natural person giving both independent and non independent advice.

#### **Wider impacts**

**158.** There are unlikely to be any wider impacts of these policy changes beyond compliance costs. We do not foresee any loss of business or adverse competitive impacts.

#### **Benefits**

**159.** The benefits of adopting the MiFID II independence standard for all types of advice are considered in relation to the alternative of retaining the current independent standard for retail clients in relation to RIPs, and the MiFID II standard for independent advice on shares, bonds, derivatives and structured deposits and for advice on all MiFID financial instruments to professional clients.

**160.** Having two independence standards in place would add complexity and confusion for consumers and firms. It might be confusing for consumers if some firms which refer to themselves as

‘independent’ were required to consider all the products in the market and others did not. It would also create particular uncertainty for firms, many of whom are likely to advise on products both in and out of MiFID scope.

- 161.** By providing guidance for firms confirming our expectations of how firms may comply with the overarching standard, it will help clarify to firms how they may demonstrate that they are meeting the requirement and provide regulatory certainty in so doing.

### **Suitability and appropriateness**

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#### **Introduction**

- 162.** These are matters where it is intended that there is a common approach across the EU, with detailed requirements contained in the MiFID II delegated regulation, and therefore we have little or no margin for discretion in implementing MiFID II for MiFID products. We therefore provide a high level cost benefit analysis.
- 163.** Our proposed approach for these issues is that the new MiFID II provisions should apply only to MiFID firms and products, and that application of new rules to non-MiFID firms and products should wait until we implement the Insurance Distribution Directive (IDD). We consider that this approach allows us to continue to meet our statutory objectives, including consumer protection. The implications for MiFID firms and consumers of the new MiFID requirements are discussed in the relevant chapter.
- 164.** We therefore retain the current rules for firms and products not covered by MiFID, including those rules which were read across when we implemented MiFID. In the case of appropriateness, this means that the current rules will continue to apply to ‘a firm which arranges or deals in relation to a non-readily realisable security, derivative or a warrant with or for a retail client and the firm is aware, or ought reasonably to be aware, that the application or order is in response to a direct offer financial promotion’. In the case of suitability, the current rules will continue to apply to insurance-based products and investments.

#### **Costs to firms**

- 165.** The new MiFID requirements include more specific requirements than before to ensure suitability of personal recommendations, such as the requirement to ensure information about the client is up-to-date if the firm is providing ongoing advice or a discretionary management service and a requirement for periodic suitability reports for discretionary management. Firms will need to make any changes necessary to allow them to comply with the additional obligations. However, we do not expect these obligations to lead to significant costs for firms. The requirement to ensure information about the client remains up-to-date reflects good practice. And firms already need to ensure suitability of their decisions when providing discretionary management services, so being required to provide an updated statement of how the investments are suitable for the client should not be onerous.

#### **Benefits**

- 166.** Consumers will benefit from the additional requirements, which should reduce the likelihood that unsuitable personal recommendations or decisions to trade will be made.

## Dealing and Managing – Best Execution

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### Introduction

- 167.** As set out in Chapter 9, we are proposing to apply, on a discretionary basis, the MiFID II best execution requirements to certain non-MiFID firms and business where this business involves the execution of orders, placing client orders for execution as part of portfolio management services, or the reception and transmission of orders to other entities for execution, in relation to MiFID financial instruments.
- 168.** In line with the approach adopted when implementing MiFID, we are proposing a general application of the improved MiFID II provisions to non-MiFID firms, in particular, Article 3 financial advisers as well UCITS management companies and other firms carrying out collective portfolio management (CPM). We also propose to extend the RTS 28 reporting requirements to full scope UK AIFMs and incoming EEA AIFM branches, and make consequential changes to the COBS rules that are already applied to these firms under COBS 18.5.4AR to reflect MiFID II reforms.
- 169.** However, we are, proposing to exempt Article 3 retail financial advisers from the requirement to publish the RTS 28 report in the interests of proportionality.
- 170.** The main aim of the MiFID II proposals is to increase the transparency of order execution to facilitate better scrutiny of performance by clients and their agents. This is fully consistent with the findings of our thematic review (TR 14/13) that the fundamental information asymmetry currently makes client scrutiny of execution outcomes difficult.
- 171.** The MiFID II best execution rules build upon the current framework in relation to the content and quality of information disclosure to be provided by firms. Firms will be subject to a higher over-arching best execution standard having to implement a policy for taking all sufficient steps to obtain the best possible result of the clients. Supplementing this incremental increase in the high-level obligation, firms will be required to disclose additional detail in their execution policies (eg information on venue selection and fees and third party payments). Furthermore, firms will be expected to check the fairness of price quoted to clients in relation to OTC products.
- 172.** MiFID II also introduces two new Regulatory Technical Standards (RTS 27 for execution venues and RTS 28 for firms carrying out client orders). RTS 27 requires execution venues to publish quality reports on execution quality. ESMA published in September 2015 a comprehensive cost benefit analysis that covers the expected impacts these new requirements may have on firms. Firms carrying out client orders (including reception and transmission) will have to comply with the disclosure requirements set out in RTS 28. This includes an annual report summarising the top five venues to which firms sent orders for execution and a summary of the analysis and conclusions drawn from their monitoring of execution quality.

### ***Approach to extending MiFID II best execution standards to Article 3 financial advisers.***

- 173.** Financial advisers exempted under Article 3 of MiFID will be affected by the FCA's discretionary proposals. These Article 3 firms are currently subject to the MiFID best execution rules since we decided to apply these standards to such firms when implementing the MiFID best execution requirements. Therefore, Article 3 financial advisers already owe a duty of best execution in all circumstances when receiving and transmitting orders for the sale and purchase of financial instruments (including units in regulated CIS) thereby putting them in the same position as MiFID financial advisers.



- 174.** We propose to maintain a similar approach by extending the MiFID II best execution requirements to Article 3 financial advisers. In the interests of proportionality, however, we intend to moderate these requirements for Article 3 financial advisers such that they will not be required to comply with the RTS 28 reporting obligation. Our proposed approach to extend the MiFID II best execution requirements in this way to Article 3 financial advisers is likely to have minimal incremental impact on these firms.
- 175.** The extent to which non MiFID financial advisers are expected to be affected is likely to be limited given that they are already subject to the MiFID best execution requirements and therefore are likely to incur only costs of minimal significance in updating their existing policies and procedures to reflect the MiFID II standards. In line with current MiFID obligations, we expect these firms to have the necessary systems in place, both in terms of their execution arrangements and monitoring in order to understand how and why orders have been executed in a particular manner. They are also required to regularly review their execution arrangements.
- 176.** In terms of the changes under MiFID II, Article 3 financial advisers would have to review and update the disclosures provided in their execution policies to reflect the improved MiFID II requirements where these are relevant to their business model and activities. These are likely to involve costs of minimal significance because the majority of these firms' activities are confined to the reception and transmission of client orders, particularly in units in collective investment schemes. In general, the additional disclosures they would need to provide in their execution policies relate to greater transparency around costs, fees and venue selection. We would expect this information to be readily available for firms to disclose in their order execution policies. Other changes under MiFID II include an amplification of current requirements, for example order execution policies will have to be customised depending on the class of financial instrument and type of service, which represents an incremental change to the MiFID requirement.
- 177.** While firms will have to review their execution arrangements and monitoring to meet the higher standard, the rules are not prescriptive in this area thereby giving firms discretion as to how to achieve this. Article 3 firms are also already subject to a requirement to review their arrangements at least annually, so they can reflect MiFID II changes and updates to disclosures in the course of their usual annual review.
- 178.** Given the nature of their services and activities which is limited to the reception and transmission of client orders, some of the enhanced best execution obligations may not be relevant, for example, the requirement to check the fairness of price in relation to OTC products.

#### **Rationale for intervention**

- 179.** The updated MiFID II provisions address policy concerns regarding investor protection, transparency and market efficiency. In particular the new requirements strengthen the existing framework with respect to execution monitoring, venue selection and information asymmetries between firms and clients.
- 180.** Our 2014 thematic review of best execution identified poor outcomes in this area. The review highlighted that firms did not understand the key elements of the best execution regime and did not adequately embed this in their business practices. It found that firms were not providing adequate information to clients in their execution policies which were found to be generic and lacking in meaningful detail. It identified that many firms were not doing enough to deliver best execution through adequate management focus, front office practices or supporting controls leading to significant risk that best execution was not delivered to all UK clients on consistent basis.



- 181.** We also took action in 2014 against a firm for breaches of the best execution rules. The firm was fined for (amongst other things) failing to check that its order execution systems were effective and that it was delivering best execution to its clients on consistent basis<sup>120</sup>.
- 182.** The general lack of transparency in this area reduces the ability of market participants to scrutinise execution quality, order routing practices and any potential conflicts, leading to poor outcomes for clients.
- 183.** The new set of rules and requirements introduced by MiFID II would help in addressing these issues as it essentially builds upon the current best execution standard. Consequently, these improved requirements should assist firms in meeting their regulatory obligations to the benefit of consumers.

#### **Baseline for analysis**

- 184.** The relevant baseline against which we measure the additional impacts of the FCA's policy is the current best execution requirements these firms are subject to, namely the requirement for firms executing client orders and/or receiving and transmitting client orders or decisions to deal to take all reasonable steps to achieve on consistent basis the best possible results for their clients.
- 185.** While the best execution regime will not radically change under MiFID II, the new requirements will raise the compliance standard and introduce several detailed and prescriptive requirements within a similar high-level framework. It will require firms to provide clients with more detailed execution policies and level of information disclosed to their clients. While we would expect most firms to provide this detail already in order execution policies under the current requirements, and indicated our expectations previously in TR14/13, the existing rules do not explicitly proscribe such detail and so some firms may need to improve their arrangements to meet the MiFID II standard. MiFID II will also require firms to assess the fairness of the price quoted when proposing OTC bespoke products. However, as mentioned earlier, this obligation is unlikely to be relevant to the business model of Article 3 financial advisers.
- 186.** The most significant change MiFID II will introduce is the obligation for firms executing client orders to publish reports on yearly basis setting out the top five venues they have sent orders to and a summary of their execution quality monitoring (as set out in RTS 28). As mentioned, in the interests of proportionality, we propose not to apply the RTS 28 reporting requirements to Article 3 firms. We think these reports would be of limited usefulness for clients, given that Article 3 financial advisers are mainly receiving and transmitting orders in units in collective investment schemes via an intermediary, typically a platform, details of which are disclosed to the clients under current requirements. We therefore think that this would impose an unnecessary cost on Article 3 firms with limited benefits for their clients.

#### **Costs**

- 187.** We first discuss the likely scope of the impacts of the policies, and then present the associated costs estimates.
- 188.** *Scope of cost impact.* While the MiFID II best execution obligations are broadly comparable to the requirements of the current FCA rules, firms will need to familiarise themselves with the new requirements and make the necessary adjustments to their current arrangements. Since firms are expected to already have the necessary arrangements in place (in line with their current obligations), they are likely to face costs of minimal significance associated with

<sup>120</sup> In 2014 we fined Forex Capital Markets Ltd and FXCM Securities Ltd (FXCM UK) £4m for best execution failures. It was also required to provide compensation of £ 6 million to its UK retail clients.

providing more detailed disclosure to clients. In general, costs are expected to be minimal for the majority of Article 3 firms which are predominantly receiving and transmitting orders in units in collective investment schemes

- 189.** *Direct costs to firms.* Article 3 financial advisers may incur some costs. The most common driver is likely to be the need to review and amend the existing disclosures contained in the firms' execution policies. However, firms are already required to review their execution arrangements on an at least annual basis. As mentioned, we therefore expect that Article 3 firms are likely to incur only costs of minimal significance when adhering to the enhanced best execution standards under MiFID II.

#### **Wider impacts**

- 190.** There are unlikely to be any wider impacts of these policy changes beyond those identified above.

#### **Benefits**

- 191.** The extension of the scope of the MiFID II best execution framework to non-scope firms would avoid regulatory arbitrage, as well as avoid situations (and associated potential detriment) where consumers engage with non-scope firms but expect the same level of disclosure as present for MiFID business (for example if they were not aware of the MiFID distinction).
- 192.** We expect that the introduction of these new reporting requirements will provide clients with valuable tools that will reduce information asymmetries and help them select the firms they wish to work with. It shall also improve competition and even the playing field across all firms (irrespective of where they are located within the European Union).
- 193.** Clients would benefit from more rigorous disclosure requirements. We expect that the enhanced disclosures provided by firms in their execution policies will help (i) inform service provider selection (ii) enhance investor protection by increasing transparency and (iii) enhance competition. This should bring positive benefits, although difficult to quantify, of reducing costs or improving investment returns for clients through a combination of choosing providers who apply more scrutiny to achieving good execution outcomes, or clients' existing providers improving their execution procedures and practices.
- 194.** Overall, we expect the changes under MiFID II may help in addressing information asymmetries between clients leading to better informed service provider selection and positive changes in firms' execution monitoring and order routing practices. We believe that extending the revised rules to non-MiFID business will help avoid inconsistent standards between MiFID and non-MiFID firms.

#### ***Approach to extending MiFID II best execution to Collective Investment Scheme (CIS) Operators, including UCITS management companies and AIFMs***

- 195.** The FCA is proposing to apply the MiFID II standards on best execution to non-MiFID firms carrying out collective portfolio management given that they carry out economically equivalent activities to MiFID portfolio managers. These firms include:
- UCITS management companies
  - Full-scope UK AIFMs and incoming EEA AIFM branches
  - Small authorised UK AIFMs and residual CIS operators

**196.** We propose to:

- level-up best execution rules to MiFID II standards for UCITS management companies subject to some modifications to tailor the provisions for collective portfolio management.
- level-up best execution rules to MiFID II standards for small authorised UK AIFMs and operators of residual CISs, subject to the current concession as provided in COBS 18.5.4R, which switches off best execution obligations where a small authorised UK AIFMs of an unauthorised AIF and operators of residual CISs only deal with professional clients and the fund documents specify that best execution requirements are dis-applied. In practice, this will mean that many of these firms will not be subject to the enhanced MiFID II best execution standards because they routinely use this exemption.
- Where the best execution provisions apply to small authorised AIFMs and residual CIS operators, we propose to apply similar modifications to the best execution provision to those that will apply for UCITS management companies. This will be included in COBS 18.5.
- Supplement the existing best execution obligations for full scope UK AIFMs and incoming EEA AIFM branches with the MiFID II RTS 28 reporting requirements and make consequential changes to the references to additional COBS best execution provisions that currently apply to full scope UK AIFMs (as currently set out in COBS 18.5.4AR) to reflect the MiFID II changes, although in substance these latter requirements remain largely the same.

**197.** While the MiFID II best execution regime is broadly comparable to the current requirements, UCITS management companies will have to review their execution arrangements to ensure they are meeting the higher standard of taking all sufficient steps to achieve the best possible results. They will also have to review and update the disclosures in their execution policies to reflect the new MiFID II requirements. Some of the new disclosures include information on venue selection and fees as well as third party payments.

**198.** Also, when taking decisions to deal in OTC products, firms will be required to check the fairness of the price proposed to the client.

**199.** The main change for UCITS management companies and full scope UK AIFMs and incoming EEA AIFM branches will be the requirement to annually publish the RTS 28 report on execution quality achieved during the year and the top five venues to which orders were passed for execution.

#### **Rationale for intervention**

**200.** Our thematic review TR14/13 on best execution identified significant failings in a number of areas. Overall, firms were found to lack a thorough understanding of their best execution obligations. The review highlighted that firms did not understand the key elements of the best execution regime and did not adequately embed this in their business practices. It found that firms were not providing adequate information to clients in their execution policies which were found to be generic and lacking in meaningful detail. It identified that many firms were not doing enough to deliver best execution through adequate management focus, front office practices or supporting controls leading to significant risk that best execution was not delivered to all UK clients on consistent basis.

**201.** We recently conducted a review of the oversight and governance of best execution by investment managers as part of our follow-up work from the thematic review. Our findings are consistent with the good and poor practice identified in the original review. We found many firms had not conducted a robust gap analysis in 2014, and therefore much of the poor practice we outlined in TR14/13 had not been addressed.

- 202.** The changes to the best execution regime under MiFID II address some of the key risks on conflicts of interest and information asymmetries between clients and their agents, which we identified in our review<sup>121</sup>.
- 203.** For the purposes of best execution, UCITS management companies and other firms carrying out collective portfolio management (CPM) present similar issues as other types of portfolio managers. Therefore, the rationale for extending our proposals to non-MiFID scope business is based on our view that the same risks apply to non-MiFID scope as to MiFID scope business. In the order to ensure consistent standards of transparency and investor protection, we consider it important to maintain a common approach between MiFID portfolio managers and non-MiFID collective portfolio managers to the best extent possible.
- 204.** A general extension of the MiFID II best execution standards would also promote fair competition in the asset management sector as all investment management activity would be subject to the same requirements. As many CPM firms delegate the investment management to a MiFID investment firm (either within the same group or to a third party), these funds would still benefit from the application of MiFID II requirements from 2018 if we did not extend the MiFID II standard. However, the funds of any CPM firms who manage assets in-house would not. Having some funds in the market that meet the MiFID II standards while others do not will make cost comparisons difficult for clients and create inconsistencies in conduct standards that may distort competition within the UK.
- 205.** Many asset managers carry out both IPM and CPM activity, managing portfolios to the same strategy and transmitting orders as a single, aggregated transaction to a venue or a broker. This creates efficiencies and economies of scale in their commercial operations that benefits their clients. So applying common best execution standards reflects and facilitates the integrated nature of dealing and managing functions within many asset managers. Hence, a number of firms that carry out CPM also do MiFID business and will be gearing up for MiFID II requirements already. We do not therefore expect there to be any additional difficulties for extending compliance requirements to non MiFID CPM in such cases.

#### **Baseline for analysis**

- 206.** The relevant baseline against which we measure the additional impacts of the FCA's policy is the current best execution requirements that these firms are subject to. These are in the form of FCA rules and guidance. For UCITS, the best execution provisions are derived from the UCITS Implementing Directive and for AIFMs the best execution rules are derived from the AIFMD Implementing Regulation (as modified and supplemented by the existing COBS 18.5).

#### **Costs**

- 207.** We first discuss the likely scope of the impacts of the policies, and then present the associated costs estimates.

#### **Scope of cost impact.**

- 208.** The scope of costs is based on a survey sent to around 200 firms carrying out investment management activities, of which 86 responded. 48 of the respondents carried out both MiFID and non-MiFID Investment management activity and mentioned that they would adopt a common procedures across their MiFID and non-MiFID business based on the MiFID II approach. Six firms mentioned that they would maintain current standards for their CPM activity rather than the MiFID II standard (assuming we did not impose it on them), and 32 firms did not provide any response.

<sup>121</sup> Notwithstanding this, we expect all firms in the sector to revisit the findings from the TR14/13 review in order to ensure they are meeting their best execution obligations.

- 209.** This suggests that most firms undertaking MiFID business would voluntarily apply any new MiFID II requirements to their non-MiFID business as part of their standard operational procedures. Given that these firms have confirmed that they will adopt a common approach across both their MiFID and non-MiFID business, this implies a baseline for our analysis that approximately 89% of firms undertaking both individual and collective portfolio management will incur only marginal incremental costs as a result of our discretionary proposals.
- 210.** Among the mixed scope firms that mentioned they would maintain current standards for best execution, and firms who only carry out non-MiFID CPM activities, there could also be a number of firms that delegate all of their management activities. Where firms do outsource 100% of the investment management, they will bear negligible (if any) costs from enhanced best execution standards, as these will be borne by the MiFID portfolio manager(s) to whom it delegates this activity. It will therefore only be a minority of CPM firms who do no MiFID business, manage their funds entirely or partly in-house, and do not make use of the concession from the best execution requirements for small scope AIFMs of an unauthorised AIF and residual CIS operators, who will incur material additional costs from enhancing their best execution arrangements to the MiFID II standard.
- Direct costs to firms***
- 211.** We estimate there are 1,044 investment managers performing some type of CPM activity. Two thirds (670) provide MiFID IPM alongside CPM activity. As mentioned above, we assume 89% of these 670 firms will incur costs of minimal significance as a result of our discretionary proposals, because they would voluntarily choose to level up to the MiFID II standards across their business regardless of our decision. This indicates that 11% of firms doing mixed scope business that may incur some costs as a result of our discretionary proposals (approximately 74 firms).
- 212.** This leaves 374 firms that perform only CPM activity without IPM permissions, plus the 74 mixed scope firms who would not otherwise level up, who are likely to be subject to costs as a result of FCA discretion (448 firms in total). However, we think a number of these firms currently delegate all of the investment management to another firm (either intra-group or to an unconnected third party). In such cases, the firm will bear no direct costs to its CPM business from the MiFID II changes, since the third party manager will be conducting IPM activity subject to MiFID requirements and so have to provide the enhanced MiFID II best execution standards. Only where a firm carrying out CPM does not delegate all of the investment management would they incur costs from our discretionary decision to extend the MiFID II best execution standards to CPM activity.
- 213.** From the survey responses, we estimate that a range of between 33% – 76% of firms do not delegate any investment management activities and therefore are likely to incur costs as a consequence of our discretionary proposals
- 214.** Based on this range, the average one-off industry costs for these firms are estimated to be between approximately £7.5 million at the lowest end and £17.1 million at top of this range. Similarly, the on-going industry costs for these firms are estimated to be between approximately £2.8 million and £6.4 million. However, we believe that some firms in their responses included both the discretionary and non-discretionary elements of the costs they are likely to incur as a result of extending the MiFID II best execution rules to collective portfolio management activities so this could be an over-estimate of costs.
- 215.** We also do not account for small authorised UK AIFMs of an unauthorised AIF and residual CIS operators who may avail themselves of the exemption from best execution where they state in fund documents that best execution will not apply in relation to the fund and no investors

in the fund are retail clients (or were at the point they invested). In such cases, these firms would not have to implement MiFID II enhancements to best execution and so would have no additional costs. This is another factor that means the above costs may be an overestimate.

- 216.** Some of the survey responses mentioned that the requirement to annually publish the top five venues or brokers to which orders were passed for execution was the most costly aspect of the new requirements to implement.

#### **Wider impacts**

- 217.** Other EU member states may not choose to apply the MiFID II standards in this area to firms carrying out CPM. Since funds can be ‘passported’ and marketed across the EU under both the UCITS Directive and (for professional investors) AIFMD, this may initially create some competitive distortion for UK funds versus EU counterparts. However, we think the benefits of common investor protection standards and est execution reforms should make UK funds more transparent and better value for money. There is also the possibility that subsequent revisions to the UCITS Directive and AIFMD may harmonise standards, meaning any differences may be temporary and at that stage UK fund managers would already meet the requirements and not need to make changes.

#### **Benefits**

- 218.** MiFID II will increase transparency on execution quality and is expected to improve execution practices of firms. In this regard, we mentioned in our thematic review TR14/13, that given the scale of assets under management in the UK, how firms perform on best execution could have a significant impact on investor returns. We also referenced research based on equity assets under management in the UK, which indicated that every basis point of cost saving could translate into £264 million in additional client returns each year as a result of proper monitoring of best execution<sup>122</sup>. While this figure was based on assets managed in the UK across both individual and collective portfolios, it indicates the potential scale of improved returns for investors in funds from even modest reductions in execution costs.
- 219.** The extension of the scope of the MiFID II best execution framework to non-scope firms would avoid regulatory arbitrage, as well as avoid situations (and associated potential detriment) where consumers engage with non-scope firms but expect the same level of disclosure as present for MiFID business (for example if they were not aware of the MiFID distinction). Applying a similar approach across MiFID portfolio managers and CIS operators would ensure that consumers benefit from consistent standards of information disclosure and investor protection.
- 220.** The RTS 28 reports introduced by MiFID II will require firms to provide information on order routing, execution, fees and rebates etc. These reports are intended to provide investors and firms of all levels of sophistication with a single landing point to scrutinise execution quality and routing decisions. They will allow for a robust comparison between different investment firms and also to enable comparison of performance over time. We expect that the introduction of these new reporting requirements will provide investors in funds and other third parties, with valuable tools that will reduce information asymmetries and help them select which firms’ funds they wish to invest in. There is also an expectation that this will feed into firms’ monitoring of their own execution quality as well as giving investors a useful tool to challenge their brokers and service providers. The reforms should also promote more effective competition on costs among collective portfolio managers over time.

<sup>122</sup> TR14/13, best execution and payment for order flow: <https://www.fca.org.uk/your-fca/documents/thematic-reviews/tr14-13>



## Dealing and Managing – Client order handling

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### Introduction

- 221.** This is a matter where it is intended that there is a common approach across the EU, with detailed requirements contained in the Level 2 delegated regulation, and therefore we have little or no margin for discretion in implementing MiFID II for MiFID products. We therefore provide a high level cost benefit analysis.
- 222.** As outlined in Chapter 9, incremental changes have been made in MiFID II to the rules dealing with client order handling and client limit orders.
- 223.** The substance of the obligations for client order handling remains unchanged under MiFID II. However, the relevant provisions now are featured in the MiFID II delegated regulation. We therefore propose to copy these out into our Handbook.
- 224.** MiFID II makes incremental updates to the rules on client limit orders which are not expected to have a significant impact on firms. Firstly, the existing requirement to disclose unexecuted client limit orders to the public with regard to shares admitted to trading on a regulated market has been extended to also include shares traded on trading venues eg MTFs. Secondly, the delegated regulation updates the existing obligation as to how firms are able to fulfil the requirement to make limit orders available to the public. This now includes the option for firms to meet the obligation where the order is published by a data reporting services provider located in one Member State and can be easily executed as soon as market conditions allow.

### Costs

- 225.** As indicated above, since there are no changes in the substance of the client order handling rules under MiFID II, we expect there to be no cost impact on firms.
- 226.** The updates to the rules on client limit orders slightly widen the scope of the obligation, however it also provides greater flexibility for firms with regard to how they are expected to make client limit orders available to the public. Firms may face a marginal cost as a result of the extended scope of the requirement to include trading venues. It may be the case that firms would need to undertake a one-off review of their current arrangements for making client limit orders public to ensure that they not only capture shares traded on a regulated market but also other types of trading venues. Since the changes to client limit order rules do not represent a significant departure from the existing requirements, and any minor adjustments to firms' practices could be included as part of the existing obligation to annually review its execution arrangements and policy, we expect any costs to firms to be negligible. With regard, to the greater flexibility provided to firms in relation to making client limit orders publically available, we do not expect this to impose additional costs on firms, rather this could mitigate any costs that may arise as a result of the widening of the scope of the requirement.

### Benefits

- 227.** The client order handling rules provide an important consumer protection mechanism where a firm executes orders on their behalf by requiring firms to have processes and procedures in place to ensure client orders are handled fairly, including where a firm aggregates orders. However, since these provisions are substantively unchanged under MiFID II, there are no new implications for clients.
- 228.** Client limit order provisions likewise are not substantively changed aside from scope, and ensure transparency of orders in a potentially wider range of shares traded on venues where they are not immediately executed. The changes to the scope of the provisions also provide firms with

more flexibility as to how they can make limit orders public. Overall, the changes may have a marginal benefit to clients by increasing market transparency and integrity.

## **Dealing and Managing – Record keeping of client orders decisions to deal and transactions**

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### **Introduction**

- 229.** MiFID II enhances the record keeping requirements on firms in respect to the items they must record for client orders, decisions to deal and transactions. The scope of the record keeping requirement has also been widened to include transactions that are carried out on own account and order processing details.
- 230.** MiFID II requires Member States to implement an ‘analogous’ record keeping regime – in line with the new requirements – for firms exempt from MiFID under Article 3 which receive, transmit or execute orders on behalf of their clients or deal on own account. Article 3 firms primarily consist of retail investment advisors and corporate finance boutiques, with a very small number of venture capital firms. The new requirements will also apply to MiFID Investment firms and UK branches of third country firms.
- 231.** While we intend to apply the revised requirements to Article 3 retail investment advisers and venture capital firms, we intend to keep the existing dis-application of the record keeping requirements under COBS 11.5 to Article 3 corporate finance boutiques as for the most part these firms are not undertaking the relevant activities which require the revised provisions to apply. However, they will be subject to the taping requirements as well as the general record keeping requirements under SYSC 9.

### **Rationale for intervention**

- 232.** As explained in Chapter 9, the revised record keeping requirements for client orders, order processing, decisions to deal and transactions will assist Competent Authorities in identifying and deterring market abuse and improve market surveillance. The enhanced requirements will also provide additional information for competent authorities that can be used to improve the regulator’s overall supervisory efforts, including identification of firm-specific and market-wide risks as well as better monitoring of firms’ compliance with their regulatory obligations, such as those on best execution or client order handling. As a result, the revised requirements will improve market integrity and strengthen investor protection.
- 233.** The improved requirements will also promote common record keeping standards at a European Level. This will help competent authorities to more effectively undertake their supervisory work where instruments are traded across jurisdictions.

### **Baseline for analysis**

- 234.** UK branches of third country firms and Article 3 retail investment advisers and venture capital firms are already subject to our record keeping requirements for client orders and transactions. These requirements are therefore the baseline for our analysis.

### **Costs**

- 235.** We begin our discussion of the costs of the policy proposals with the likely scale of impact across the different groups of firms, and then present the direct cost estimates.

### **Likely scope of costs**

- 236.** The direct cost impact of applying the MiFID II record keeping requirements to affected firms is likely to be relatively widespread – for example around 60 per cent of relevant respondents to



our survey indicated they would incur some costs. However, the majority of these indicated that they did not expect complying with the new requirements to be too onerous and envisaged that the new provisions would mostly result in a moderate extension or an update to their existing procedures.

#### **Direct costs**

- 237.** One-off costs for MiFID Investment firms, UK branches of third country firms and Article 3 retail investment advisers would be driven by staff training and legal and compliance costs, including time spent developing new policies and procedures. Costs arising from changes to IT systems would also be relevant.
- 238.** Ongoing costs associated with the new requirements for MiFID Investment firms, UK branches of third country firms and Article 3 retail investment advisers would include IT maintenance, data gathering and processing (the latter will vary depending on how IT-intensive the record-keeping system is).

#### **Wider impacts**

- 239.** While the majority of respondents have indicated that they expect the requirements to have little, if any, impact to their business, a significant minority have expressed concern over the additional administrative and compliance burden arising from the revised regime, resulting in less time spent with the end-client and with the costs arising from implementing the changes ultimately being passed on to the client.

#### **Benefits**

- 240.** It is not reasonable practicable to estimate the benefits from record keeping. As described above, the record keeping requirements under MiFID II change the current provisions in two main ways: they widen the scope of the requirements to include transactions carried out on own account and order processing; and they increase the number of items firms are required to record and keep in respect of client orders, decisions to deal, order processing and transactions.
- 241.** The benefits stemming from the additional details for firms to record are described in ESMA's cost-benefit analysis. For example, the precise time stamp and characteristics of orders transmitted to trading venues by market members or participants (or received by the latter from their clients) can demonstrate whether information which is not publicly available has been used (insider dealing) or that the price-setting mechanism of financial instruments has intentionally been distorted (price manipulation).
- 242.** The harmonising of information on orders and transactions and the use of standardised formats will improve our market monitoring abilities, especially as currently some of the key details of an order such as trader or algorithm identification, sequence numbers, etc. cannot be always obtained from trading venues.
- 243.** Other benefits of the new record keeping requirements are as follows:
- facilitates our use of cross-market information
  - improves our market surveillance
  - helps us in detecting and deterring market abuse
  - enhanced our overall supervisory efforts
  - promotes common record keeping standards across the EEA

- improves accountability of firms receiving, transmitting or executing client orders or decisions to deal
- provides firms with an enhanced data set to improve internal controls and the design of their policies and procedures
- allows firms to better demonstrate their compliance with their regulatory obligations

### Dealing and Managing – Personal account dealing

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- 244.** As outlined in Chapter 9, the substance of the personal account dealing requirements is unchanged under MiFID II. However, the relevant provisions are now in the MiFID II delegated regulation. We therefore propose to copy these out into our Handbook as a new section, while retaining the current requirements in COBS 11.7 for non-MiFID firms to whom this section currently applies. This requires some consequential changes to application provisions and existing cross-references to MiFID accordingly.
- 245.** This is a matter where it is intended that there is a common approach across the EU, with detailed requirements contained in the Level 2 delegated regulation. Therefore we have little or no margin for discretion in implementing MiFID II for MiFID products. We therefore provide a high level cost benefit analysis.

We therefore estimate that there will be no incremental costs and benefits as a result of these policy changes.

### Underwriting and placing

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#### Introduction

- 246.** MiFID II introduces new provisions for firms to manage conflicts of interest and to disclose information relevant to underwriting and placing activities, which are set out in Articles 38 to 43 of the MiFID II delegated regulation. This is a matter where it is intended that there is a common approach across the EU, with detailed requirements contained in the MiFID II delegated regulation, and therefore we have little or no margin for discretion in implementing MiFID II for MiFID products. We therefore provide a high level cost benefit analysis. We are proposing to extend the application of these new MiFID II requirements on underwriting and placing to third country firms carrying out such activity in the UK.

#### Rationale for intervention

- 247.** A number of conflicts of interest can arise during underwriting and placing activities. Indeed, various risks have emerged across the market in recent years, including:
- the pricing of an offering promoting the underwriting and placing firm's own interests, rather than those of the issuer client
  - the allocation of securities by the underwriting and placing firm in a way that is skewed towards to their top-dealing clients or their own asset management arms, and

- the placement of financial instruments issued by the underwriting and placing firms themselves (or by entities within the same group) to their own clients, including existing depositor clients in the case of credit institutions

**248.** The new underwriting and placing provisions in Articles 38 to 43 are designed to address these types of risks. These risks may also be apparent amongst third country firms carrying out underwriting and placing activities in the UK, we propose applying the new requirements as rules to third country firms. In order to avoid regulatory arbitrage and ensure consistency with the EU principle that third country firms should be treated 'no more favourably' than EEA firms, it is necessary to apply the underwriting and placing requirements as rules.

#### **Baseline for analysis**

**249.** The baseline for analysis is our overarching conflicts of interest rules in SYSC 10 and our specific guidance in SYSC 10 on the management of a securities offering.

**250.** Our current conflicts of interest rules in SYSC 10 require firms to identify, record and manage conflicts of interest and these apply to underwriting and placing activities. Prior to the introduction of MiFID, there was more detailed guidance on underwriting and placing activities within COB 5.1. When MiFID was implemented, this guidance was replaced with the current guidance in SYSC 10.1 on the management of a securities offering, although our regulatory expectations in this area remained unchanged. SYSC 10.1.14G reminds firms that, during a securities offering, its duty is to its corporate finance client but that its responsibilities to provide services to its investment clients are unchanged. SYSC 10.1.15G contains guidance on measures a firm may wish to consider including in its conflicts of interest policy in relation to the management of a securities offering.

#### **Costs**

**251.** There are approximately 120 third country firms in the UK. To the extent that these third country firms carry out underwriting and placing activity in the UK, the new requirements relating to underwriting and placing will require these firms to establish specific measures to ensure compliance, if they do not already exist. There will be some resource implications, particularly around the new disclosure of information requirements, which are not explicitly required under our existing SYSC guidance.

#### **Benefits**

**252.** It is not reasonably practicable to estimate the benefits from this policy. The new MiFID II requirements add rigour to the conflicts of interest principles in SYSC 10 and reinforce protection by ensuring that firms act in the best interest of their issuer clients. The new requirements for firms to disclose relevant information related to underwriting and placing will provide greater transparency to the issuer about possible conflicts of interest and enable them to make a more informed choice at various stages of a securities offering process.

**253.** MiFID II has introduced some targeted requirements aimed at addressing risks that have emerged across the market in recent years. For example, there are some specific requirements designed to ensure that the pricing of an offering should promote the interests of the issuer client. These should help to improve the efficiency and integrity of the price formation process and avoid any mispricing.

**254.** There are also a number of explicit provisions requiring firms to allocate securities to investors in a way that best serves the interests of the firms' issuer client.

255. The requirements will also help to improve the protections to firms' investment clients that subscribe to securities as part of the offering process, eg through supporting efficient price formation and a fair allocation of securities.

## Investment research

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### Introduction

256. MiFID II changes the rules around investment research by introducing a new requirement for firms to maintain a physical separation between financial analysts and 'other relevant persons', as an additional measure to manage possible conflicts of interest. This requirement is set out in Article 37(2)(C). Under this provision, physical separation should exist unless it is not considered to be appropriate to the size and organisation of the firm, as well as the nature, scale and complexity of its business. In these circumstances, the firm is required to establish and implement appropriate alternative information barriers.
257. In line with our approach to implementing MiFID, we are proposing to extend the application of this new MiFID II requirement on investment research to third country firms, Article 2 energy market participants (EMPs) and oil market participants (OMPs), and Article 3 firms carrying out corporate finance business, since they may be subject to the same conflicts of interest.

### Rationale for intervention

258. The new MiFID II requirement for investment research addresses potential conflicts of interest between the analysts involved in the production of investment research and other staff whose responsibilities and interests may conflict with those of the recipients of the investment research. It aims to ensure the objectivity and impartiality of investment research. For example, in primary equity and debt issuance, investment banking staff serve the issuer client with the aim of maximising capital being raised, whereas the research analysts serve prospective investors which are the recipients of investment research. The investment research must, therefore, be an objective opinion on the present or future value or price of one or more financial instruments or the issuers of financial instruments. Without adequate controls and systems in place to manage the flow of information between parties, it is more likely that those with conflicting interests will be able to exert influence over the research product, to the detriment of the recipients.
259. These risks may also be apparent amongst third country firms producing and disseminating investment research in the UK. We propose applying the new requirement as a rule to third country firms. In order to avoid regulatory arbitrage and ensure consistency with the EU principle that third country firms should be treated "no more favourably" than Union firms, it is necessary to apply the new investment research requirement as a rule.
260. Similarly, these risks may also arise with Article 2 OMPs and EMPs, along with Article 3 firms carrying out corporate finance business. For example, OMPs and EMPs may take proprietary positions in energy or oil markets, whilst corporate finance firms may be advising a corporate client on a securities offering. In such cases, commercial interests in one part of the business may conflict with the research analysts' production of investment research.

### Baseline for analysis

261. The baseline for the CBA analysis is our existing overarching conflicts of interest rules in SYSC 10, and our existing rules on managing conflicts of interest in the production and dissemination of investment research in COBS 12.2, which apply to third country firms, EMPs and OMPs and firms carrying out corporate finance business. The only additional element introduced by

MiFID II is the need for physical separation, or at least information barriers, between financial analysts and other relevant persons.

### Costs

- 262.** There are an estimated 15-20 firms classified as EMPs or OMPs, 565 firms carrying out corporate finance business, and approximately 120 third country firms operating in the UK. Since the existing provisions in SYSC 10.1 and COBS 12.2 already set out requirements for the use of information barriers, this new provision is unlikely to have a material impact on the way that conflicts of interests relating to the production and dissemination of investment research are managed by Article 2 OMPs and EMPs and Article 3 firms carrying out corporate finance business. As such, we would not expect any material impact on the potential compliance burdens of these firms. In line with our current regulatory expectations, the requirement also provides the option for a firm to consider alternative information barriers if physical separation is disproportionate for a firm.
- 263.** In fact, for OMPs and EMPs, our survey and associated fieldwork suggests that it is highly unlikely that any of these firms undertake investment research along the lines of that subject to the policy proposals. The same applies to the majority of other firms responding to our survey which are involved in energy and oil markets (although not officially categorised as EMPs or OMPs). The few firms in the latter group that do undertake some investment research do not consider the new requirement to impose any additional changes to their current business practice and therefore to have any incremental costs. It is therefore our view that the application of this policy would have a negligible impact on the industry, with costs of minimal significance.

### Benefits

- 264.** To the extent that third country firms, non-MiFID OMPs and EMPs, and Article 3 firms carrying out corporate finance business produce and disseminate investment research now or in the future, there will be benefits from a more robust set of policies managing conflicts of interest. The new requirement for these firms to introduce physical barriers, unless it is not proportionate to do so, should further improve the independence of the research. This should, therefore, reduce the likelihood that the investors using the research make investment decisions on the basis of material that may not be impartial. Moreover, having to implement a physical barrier between analysts and all other staff should have the benefit of reducing the likelihood of someone misusing sensitive information originating from within the research department.
- 265.** A more robust set of policies managing conflicts of interest in the production and dissemination of research should, in turn, create the wider benefit of enhancing the integrity of the research market and confidence across the wider financial markets. This helps consumers to make better informed investment decisions, and encourages investment activity and liquidity in primary and secondary markets.

## Other conduct issues - client agreements

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### Introduction

- 266.** This is a matter where it is intended that there is a common approach across the EU, with detailed requirements contained in the MiFID II delegated regulation, and therefore we have little or no margin for discretion in implementing MiFID II for MiFID products. We therefore provide a high level cost benefit analysis.
- 267.** Our proposed approach for these issues is that the new MiFID II provisions should apply only to MiFID firms and products, and that application of new rules to non-MiFID firms and products

should wait until we implement the Insurance Distribution Directive (IDD). However, we propose to introduce the new MiFID II record keeping requirement for non-MiFID business other than pension transfers, pension conversions, pension opt-outs or FSAVC, for which records will continue to be required to be kept indefinitely. So for both MiFID and non-MiFID business, the requirement will be to keep records for at least the duration of the relationship with the client (and not for at least 5 years, if longer).

- 268.** We consider that this approach allows us to continue to meet our statutory objectives, including consumer protection.

### **Costs**

- 269.** Firms already have to provide client agreements to retail clients. In future they will also need to provide client agreements to professional clients, although in practice they are likely to do so already, so we do not expect this to be an onerous requirement. The requirements include greater detail for information to be included in client agreements, although again we expect that firms will already provide this information to their clients. So we do not expect firms to need to make major changes to their systems to produce the relevant agreements.

- 270.** Firms will now be able to keep records for less than five years, if the relationship with the customer lasts for less than five years, except for certain pensions business (where records will continue to need to be held indefinitely), so will be able to decide for themselves whether, and if so, for how long, they wish to keep records after the relationship with a particular client has ended. Given that this is a relaxation of the current requirements (which require records to be kept for at least 5 years if this is longer than the relationship with the client), we consider this proposal to result in costs of minimal significance to firms.

### **Benefits**

- 271.** Professional clients will in future receive client agreements with the detailed information set out in the Regulation, and this will ensure that they receive a certain level of information if firms do not already provide this. Consumers already receive client agreements under the current provisions. We expect consumers to benefit from the new provisions, as greater and more detailed information on their investments is expected to help consumers make more informed financial decisions.

## **Product governance**

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### **Introduction**

- 272.** MiFID II will require firms to meet certain product governance standards. These are procedures firms should follow in the design, distribution and ongoing monitoring of products over their full lifespan. In this section, references to 'products' include financial instruments and structured deposits.

- 273.** This is a matter where it is intended that there is a common approach across the EU and therefore we have little or no margin for discretion in implementing MiFID II. We therefore provide a high level cost benefit analysis for firms acting within MiFID scope, for firms undertaking equivalent third-country business and for firms distributing MiFID products under the Article 3 exemption.

- 274.** We are also considering applying the provisions as guidance to firms acting outside of MiFID scope when producing or distributing MiFID-scope investments. This will add to existing product governance guidance set out in the Responsibilities for Product Providers and Distributors for the Fair Treatment of Customers (RPPD). The policy proposal will affect firms producing

and distributing MiFID Instruments by way of non-MiFID business, such as AIF managers and UCITS managers.<sup>123</sup>

#### Rationale for intervention

- 275.** As noted in our paper on behavioural economics,<sup>124</sup> consumers often make predictable mistakes when choosing and using financial products. These behavioural biases can lead firms to compete in ways that are not in the interests of consumers; for example, in the choice of product features. Therefore, decisions firms make about product governance can have a major impact on consumer outcomes.
- 276.** In many financial services markets, such as for long-term investments, consumers often cannot learn from their mistakes in ways that allow them to put pressure on manufacturers to compete effectively by offering good quality and value products. In these circumstances, firms may benefit from using this lack of consumer pressure by, for example, using opaque charging structures or lower quality levels.
- 277.** Consumers are suffering detriment because of failures in the current product governance processes of product manufacturers and distributors.<sup>125</sup> Supervisory work, for example, found unsuitable sales in 16.3% of advice to invest on platforms and that suitability was not proven in 26% of mystery shopping reviews into the quality of investment advice by banks.<sup>126</sup> Of the investment files assessed by the FSA as unsuitable between March 2008 and September 2010, half were rated unsuitable on the grounds that the investment selection failed to meet the risk a consumer was willing and able to take.<sup>127</sup>

#### Baseline for analysis

- 278.** The baseline for this analysis is the existing guidance on the production and distribution of products as set out in the RPPD. This guidance covers target markets, risk assessment and product stress-testing, information provision to distributors and consumers, and complaints and redress.
- 279.** The policy proposal will extend the guidance in several areas.
- 280.** For manufacturers:
- product design (including charges) and distribution strategy should meet the needs of the target market and the firm should identify groups for whom the product is unlikely to be suitable
  - firms should consider the impact of new products on the orderly functioning of the market
  - firms working together to develop a single product should have a written agreement setting out their share of these responsibilities

<sup>123</sup> Where managers carry on MiFID activities, they will be subject to certain MiFID rules in relation to those activities.

<sup>124</sup> Occasional paper 1, Applying behavioural economics at the Financial Conduct Authority, April 2013: <https://www.fca.org.uk/static/documents/occasional-papers/occasional-paper-1.pdf>

<sup>125</sup> See, for example, *Structured products: Thematic review of product development and guidance*, March 2015: <https://www.fca.org.uk/static/documents/thematic-reviews/tr15-02.pdf>, CP12/19, *Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes*, August 2012: <http://www.fca.org.uk/static/pubs/cp/cp12-19.pdf>, CP14/23, *Restrictions on the retail distribution of regulatory capital instruments*, October 2014: <http://www.fca.org.uk/static/documents/consultation-papers/cp14-23.pdf>.

<sup>126</sup> *Investment advice and platforms: Project findings*, March 2010: [http://www.fsa.gov.uk/pubs/other/iap\\_findings.pdf](http://www.fsa.gov.uk/pubs/other/iap_findings.pdf) and *Assessing the quality of investment advice in the retail banking sector: A mystery shopping review*, February 2013: [http://www.fsa.gov.uk/static/pubs/other/thematic\\_assessing\\_retail\\_banking.pdf](http://www.fsa.gov.uk/static/pubs/other/thematic_assessing_retail_banking.pdf)

<sup>127</sup> FG11/05, *Assessing suitability: establishing the risk a customer is willing and able to take and making a suitable investment selection*, March 2011: <https://www.fca.org.uk/static/documents/final-guidance/fsa-fg11-05.pdf>



- the compliance function at the firm should monitor product governance, and
- firm management boards should have oversight and control of the governance process

**281.** For distributors:

- before distributing a product, firms should consider for which target market it is likely to be suitable and any groups for whom it is unlikely to be suitable
- the distribution strategy should meet the needs of the target market
- products should be reviewed regularly to confirm they remain consistent with the target market's needs, and firms should make changes to the distribution strategy or other processes if they identify problems
- firms should provide information on sales to product manufacturers and, where appropriate, also provide them with information on the regular reviews
- the compliance function at the firm should monitor product governance
- firm management Boards should have oversight and control of the process, and
- firms working together to distribute a single product should have an agreement setting out their share of these responsibilities and to share information

**Costs**

**282.** Where firms do not already have product governance processes in place, there will be costs for compliance, including in the development of new processes and managing those processes each year.

***Direct compliance costs for manufacturer firms***

**283.** Based on responses to the survey, we estimate that approximately 40% of firms will incur incremental costs from the extended guidance based on MiFID II.<sup>128</sup>

**284.** Based on the survey results, we expect that the greatest contributor to one-off costs for manufacturer firms will be legal and compliance costs, followed by setting up arrangements to manage relationships with other firms, such as distributors, and training staff about the new procedures. However, there is significant uncertainty as to the magnitude of these costs, stemming from respondent firms' uncertainty about how the additional guidance would affect them in practice.<sup>129</sup> We therefore estimate a possible one-off market-wide cost of £3.1 million.<sup>130</sup>

**285.** Firms reported that the greatest expected ongoing costs will be in managing relationships with other firms about the product design and distribution process. Other notable ongoing costs include product testing and compliance monitoring. Firms noted that the process for developing and monitoring products may need to be expanded and could involve more staff time and more documentation.

<sup>128</sup> Our survey in relation to product governance was addressed to firms undertaking a range of activities in order to receive a broad spread of responses. Our proposals are to a more limited range of firms. However, the firms which took part in the survey and would be subject to our proposals reported estimated costs broadly in line with the costs reported by the wider range of respondents. We estimate that 187 firms will be affected by our proposals.

<sup>129</sup> One-off cost estimates reported in the survey range from £11,000 to £70,000 per firm.

<sup>130</sup> This estimate does not include the cost estimates in our survey of one outlier firm. If we took their figures into account, the one-off estimated cost to the market would increase to £5.9 million.



**286.** Ongoing costs are estimated to be larger than one-off costs given the nature of the cost drivers and the need to continue these additional processes throughout the lifetime of new products.<sup>131</sup> We estimate a market-wide ongoing cost of £5.6 million per year.<sup>132</sup>

**287.** We note that the costs per firm are likely to overestimate true costs and represent an upper bound, particularly for ongoing costs. This is due to the uncertainty some responding firms expressed in estimating the additional requirements that would result from the extended guidance. We also note that this is additional guidance building on existing guidance, rather than creating entirely new provisions. We therefore expect the costs to be closer to the lower than the upper band.

#### ***Direct compliance costs for distributor firms***

**288.** Approximately half of respondents to our survey said that they already undertake some of the product governance processes set out in the new provisions.<sup>133</sup>

**289.** We expect that, for firms that do not already meet the new provisions, the greatest contributor to one-off costs for distributor firms will be in developing new processes and systems, including IT systems, to comply with the new provisions, followed by the costs of training staff about the new procedures.<sup>134</sup> We estimate a total one-off cost across affected firms of £5.2 million.<sup>135</sup>

**290.** Ongoing costs are likely to consist mainly of time spent managing relationships with manufacturer firms and reviewing new products to ensure compliance. Ongoing staff training in terms of new product governance procedures was also cited by firms as a major contributor to ongoing costs.<sup>136</sup> We estimate ongoing costs across affected firms of £4.4 million per year.<sup>137</sup>

#### **Wider impacts**

**291.** While many respondent firms reported that they do not expect any wider impacts as a result of the new guidance such as changes to business models or overall competition, we anticipate some wider impacts for some firms in terms of the range of distribution channels employed and the type of products produced (including a potential rationalisation of existing products and potential reduction in innovation, with a negative impact on firms that cannot adjust their business models in a way that complies with the provisions in a way that is profitable).

**292.** Uncertainty around the nature of the relationship between manufacturers and distributors, and the extent to which responsibility for product governance is shared, could result in:

- product manufacturers making their products as broad as possible, to reduce the risk that they are sold to the 'wrong' target audience
- product manufacturers may also make products tailored to more focused target markets

<sup>131</sup> Ongoing cost estimates reported in the survey range from £25,000 to £31,000 per firm.

<sup>132</sup> This estimate does not include the cost estimates in our survey of one outlier firm. If we took their figures into account, the one-off estimated cost to the market would increase to £22.6 million.

<sup>133</sup> We estimate that 220 firms will be affected by our proposals. Many of these firms are also likely to be subject to the product governance provisions for manufacturer firms. While this may result in some duplication in the cost estimates, since there are some similarities between the manufacturer and distributor provisions, we do not expect this impact to be too marked as the guidance will still apply to activities at different stages of the value chain.

<sup>134</sup> One-off cost estimates reported in the survey range from £13,000 to £52,000 per firm.

<sup>135</sup> This estimate does not include the cost estimates in our survey of one outlier firm. If we took their figures into account, the one-off estimated cost to the market would increase to £6.9 million.

<sup>136</sup> Ongoing cost estimates reported in the survey range from £11,000 to £44,000 per firm.

<sup>137</sup> This estimate does not include the cost estimates in our survey of one outlier firm. If we took their figures into account, the one-off estimated cost to the market would increase to £4.9 million.

- distributors may choose to distribute funds that have a 'broad' target market to avoid the risk that they sell a niche product to the wrong target market

**293.** This may have an impact for consumers, potentially reducing product innovation and choice. In practice, however, we would expect that many of the products that would no longer reach consumers would not be appropriate for them. Removing such products from the market may actually be a benefit. There are also likely to be other improvements to products so that they are designed to meet consumers' interests.

### **Benefits**

**294.** Consumer harm caused by poor product design, development and delivery can occur for a variety of reasons. However, we have found from past product failures that consumer detriment often occurs when firms fail to put consumer needs at the centre of their product governance processes. If firms have robust product governance processes, focused on treating consumers fairly, this will help ensure product design and distribution are more likely to meet consumer needs and minimise the risk of consumer detriment and potentially expensive redress exercises.

**295.** The main benefit we expect is a reduction in consumer detriment. To achieve this, the additional provisions under MiFID II which we are intending to extend as guidance to firms providing and distributing MiFID Investment products by way of non-MiFID business aim to reduce consumer harm by helping firms improve their product governance processes. For example, if a firm undertakes analysis which shows that the proposed charges are not appropriate, they may amend the charging structure, leading to lower charges and improving consumer returns. The product governance processes should also support other areas, such as helping develop product disclosures or financial promotions that are tailored to the target market, and in assessing appropriateness or suitability.

**296.** To provide an indicative quantification of the potential benefits, we have considered possible benefits based on some of our previous work.

- By focusing retail distribution of non-mainstream pooled investments on markets for whom we judged the investments to be most suitable, and avoiding groups for whom we judged the investments as generally unsuitable, we estimated there would be a reduction in the amount of unsuitable investment of between approximately £680m and £2.3bn (between approximately £135m and £460m each year, assuming that investments are held for five years).<sup>138</sup>
- For similar reasons, our work on contingent convertible securities estimated benefits of between £16m and £235m (between approximately £3.2m and £47m each year, assuming that investments are held for five years).<sup>139</sup>

**297.** This suggests scope for considerable benefits through reduced consumer detriment. Firms applying improved product governance standards are likely to lead to reduced consumer detriment.

**298.** While the above cases are those where we identified particularly high risks of mis-selling, we consider there to be more widespread benefits. To quantify these benefits, we assume:

- in line with data from the survey, average assets under management of £300 million per firm

<sup>138</sup> PS13/03, *Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes*, June 2013: <https://www.fca.org.uk/static/documents/policy-statements/ps13-03.pdf>

<sup>139</sup> CP14/23, *Restrictions on the retail distribution of regulatory capital instruments*, October 2014: <http://www.fca.org.uk/static/documents/consultation-papers/cp14-23.pdf>

- annual investment of £60 million per firm assuming that investments are held for five years
  - unsuitable sales in 16.3% of cases, as in the platform advice review cited earlier
  - improved product governance processes at manufacturer and distributor firms, in line with the additional guidance on which we are consulting, reduces unsuitable advice by a range of between 1% (this would mean that the overall rate of unsuitable sales reduced 0.163%) and 5% (leading to a 0.815% reduction in the rate of unsuitable sales)
- 299.** On this basis, we estimate a range of total annual benefits between £21.5 million and £107.6 million.

### Knowledge and competence requirements

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#### Introduction

- 300.** ESMA guidelines are subject to the 'comply or explain' process in article 16 Regulation 1095/2010 (establishing ESMA) and are addressed to competent authorities or, as the case may be, market participants. Competent authorities and financial market participants must make every effort to comply with these.
- 301.** The purpose of the guidelines is to improve investor protection by increasing the knowledge and competence of individuals in investment firms providing information or advice to clients on services and financial instruments across Member States. It is intended that there is a common approach across the EU.

#### Costs

- 302.** The current MiFID framework already requires investment firms to have personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them. The UK already has well established conduct requirements, including specific rules on knowledge and competence, designed to achieve this. Consistent with ESMA's view when consulting on the guidelines the cost impact for Member States, including the UK where extensive regulation is already in place, will be of minimal significance.
- 303.** In complying with the ESMA guidelines we are implementing changes necessary to comply but we are not going beyond what is necessary. We are not extending the scope of the existing TC regime on appropriate qualifications to those employees who are not currently subject to it, for example, those who give investment advice to professional clients and employees that give information to retail and professional clients. Instead we propose to give firms flexibility in how they provide their employees with the knowledge and competence necessary to comply with the guidelines. This will help ensure that the delivery of the knowledge and competence is proportionate and targeted based on the firms' sizes and complexities, the needs of employees subject to the guidelines and the scope and degree of the relevant services provided by the firm. This will enable firms to leverage their established TC policies and procedures when complying such as using in-house training, needs based and annual assessments, continuous professional development and new product training.
- 304.** One-off costs for firms will be dependent on each firms' established policies and procedures in respect of training and competence, the scope and degree of the relevant services provided by their employees and their existing knowledge and competence. Costs are likely to include an assessment of the new requirements, any training or support necessary to comply and any need to work under supervision in the interim. On-going costs for firms will be consistent

with their existing regulatory obligations to employ competent employees eg providing training on new products and legislation where relevant, continuous professional development and compliance monitoring. We do not propose to introduce any new data reporting requirements to comply with these guidelines.

### **Benefits**

- 305.** The benefits of the new guidelines will include more transparent, proportionate, accountable and targeted knowledge and competence requirements for employees providing information or advice to clients on services and financial instruments across Member States.
- 306.** This greater harmonisation of knowledge and competence across all Member States introduced by the guidelines should contribute to improved standards of knowledge and competence by employees providing information and advice to clients of the investment firms.
- 307.** Overall, the benefits introduced by these new guidelines should bring a higher degree of investor protection and service to clients, as well as reduced risks of client detriment and improper conduct.

## **Recording of telephone conversations and electronic communications (taping)**

### **Introduction**

- 308.** MiFID II introduces a requirement for firms to record telephone conversations and electronic communications when undertaking specific client order services and dealing on own account. We have a domestic taping policy in place already, which for the most part aligns with MiFID II, so for the majority of investment firms, we do not envisage significant change to comply with MiFID II.
- 309.** The MiFID II taping provision is minimum harmonising. This allows us to consider whether to extend the recording requirement to other relevant activities undertaken by MiFID firms. We propose to continue to apply a taping regime to the service of portfolio management, with some modifications in respect to the current partial exemption for discretionary investment managers and the exclusion of corporate finance business.
- 310.** MiFID II extends an at least analogous requirement to firms falling outside of the scope of our existing taping framework by virtue of Article 3 of MiFID II. These include financial advisers, corporate finance boutique firms and venture capital firms.
- 311.** MiFID II requires that Member States do not treat branches of non-EEA firms more favourably than branches of EEA firms. We therefore propose to apply the MiFID II taping provisions to these firms.
- 312.** The policy proposals analysed in this CBA are:
- For firms (including MiFID firms) providing the service of portfolio management: apply the requirements under MiFID II and remove the exemption for some discretionary investment managers (DIMs).
  - For MiFID firms and Article 3 firms: remove the current domestic exemptions from the obligation to record for corporate finance business, financial advisers and apply the requirements under MiFID II to this activity and type of firm.

- For some non-Directive firms undertaking the relevant activities apply the requirements under MiFID II. The non-MiFID firms include: collective portfolio managers (full-scope UK AIFMs, small authorised UK AIFMs, residual CIS operators, incoming EEA AIFM branches and UCITS management companies) and firms carrying out energy market activity or oil market activity.
- For non-EEA third country branches undertaking the relevant activities: apply the requirements under MiFID II.

### Rationale for intervention

- 313.** Access to records of electronic communications and telephone conversations is an important tool available to regulators and firms as it can assist in ensuring compliance with conduct of business obligations and help to deter and detect market abuse.
- 314.** Market abuse has significant detrimental impacts on financial markets.<sup>140</sup> These include distorting price signals and undermining investor confidence, which can lead to reduced market efficiency, liquidity and financial stability. Market abuse is related to market failures such as asymmetric information (whereby some market participants hold more information than others which enables them to manipulate markets without other participants being aware). Negative externalities, whereby the negative impacts to the market as a whole significantly outweigh the potential negative impacts to firms committing the abuses, means that firms do not internalise these costs when committing the abuse. Market abuse undermines one of our fundamental objectives of upholding market integrity.
- 315.** Non-compliance with obligations under MiFID II may lead to an increase in the number of cases of misselling of financial services products. A rise in the number of such cases could have a serious impact on investor confidence which could create further market disorder and systemic risk. This undermines our objective of consumer protection.
- 316.** MiFID II does not require the recording of all activities where detriment may arise, for example in relation to all **corporate finance business or the service of portfolio management**. This raises the potential for gaps in oversight and regulatory arbitrage. It also raises the risk that detriment caused by market abuse and non-compliance with conduct of business obligations, as described above, will not be sufficiently addressed in the UK.
- 317.** With respect to **Article 3 firms** (namely corporate finance boutiques and financial advisory firms) MiFID II requires us to introduce a regime “at least analogous” to the taping requirements articulated under the Directive. We believe there are real benefits in applying a taping requirement to Article 3 firms. There has been an upward trend in the sales of investment products to retail clients over the last number of years. We expect this to continue following changes to the rules governing pensions, ISAs and the Bank of England’s base rate. However, we are aware that the majority of complaints that the FOS receives about investments centre around the conversations that happen when they are sold. The existence of tapes will therefore provide a clear audit trail of the intention and understanding of the parties leading up to the conclusion of a transaction, particularly in cases when allegations of misselling arise. We believe that consumers will also benefit from the self-disciplining effect on advisors from recording calls. Other benefits include providing supervisors with an additional tool when undertaking thematic reviews or mystery shopping exercises. Access to tapes will also provide our Enforcement division with an additional source of evidence. We also expect the market to

<sup>140</sup> For example, the financial crisis and subsequent post crisis events such as the LIBOR and FX manipulation enforcement cases revealed significant deficiencies in wholesale markets.

become more diverse in the delivery of its advice and it is important for the regulator to be ahead of likely market innovations and developments in electronic communications.

- 318.** We currently apply taping rules to some **non-Directive firms** undertaking the relevant client order services and dealing on own account. This includes firms carrying out energy market activity and oil market activity and the activities of collective portfolio managers (full-scope UK AIFMs, small authorised UK AIFMs, residual CIS operators, incoming EEA AIFM branches and UCITS management companies). MiFID II requires that Member States do not treat **branches of non-EEA firms** more favourably than branches of EEA firms. We therefore propose to apply the MiFID II taping provisions to these firms. Our domestic regime already requires that firms record relevant activities where they take place in the UK, retaining this requirement to record and implementing MiFID II organisational requirements will aim to prevent detriment as described above from arising.
- 319.** Our proposals therefore aim to provide us with additional means to achieve our statutory and operational objectives. It will also provide us with an extra regulatory tool to take action, including in the case of unforeseen matters or future events. It also supports the objectives of FEMR, which has made a number of recommendations on enhancing the fairness and effectiveness of markets and benefits of technology to reduce /remove the scope for poor wholesale conduct.

#### **Baseline for analysis**

- 320.** The baseline for our CBA is the situation in which we do not exercise our discretion in implementing MiFID II. We describe the baseline for each type of firm affected.
- **Corporate finance business:** Without action by us, firms would not be required to tape telephone conversations and electronic communications relating to corporate finance business. The baseline would be the current situation, namely no taping requirements for this activity.
  - **Portfolio management business:** Without action by us, firms would not be required to tape telephone conversations and electronic communications relating to portfolio management business. However under our current rules, this activity is subject to a taping regime, with a qualified exemption for discretionary investment managers. The domestic rules differ in certain respects to those in MiFID II, for example MiFID II additionally requires that:
    - Records must be retained for 5 years, rather than 6 months.
    - Firms need to maintain a written policy on telephone recording requirements, also to include internal calls to be recorded and procedures to be followed where exceptional circumstances arise and the firm cannot record the call. Firms must have evidence of these circumstances.
    - Firms must train employees.
    - Firms must periodically monitor the records.

To the extent that discretionary investment managers do not apply the exemption, the baseline is already fairly close to the new proposals.

- **Article 3 firms:** Without action by us, Article 3 firms that comprise of financial advisory firms, corporate finance boutiques and venture capital firms would not be required to tape telephone conversations and electronic communications.

- **Non-Directive firms:** Without action by us, these firms are not subject to a taping regime under MiFID II.
- **Third country branches:** Under European legislation we cannot treat these firms more favourably than MiFID Investment firms.

### Costs

321. We begin our discussion of the costs of the policy proposals with the likely scale of impact across the different groups of firms, and then present the direct cost estimates.

#### *Likely scope of costs*

##### *Corporate finance business*

322. The proposal to bring corporate finance business within the scope of the taping regime is likely to impact a wide range of firms. The large majority of respondents to our CBA survey told us they do not currently tape their corporate finance business. This applies irrespective of the size of the firm; and includes those firms that currently tape other parts of their business (eg integrated investment banks).

##### *Portfolio management business*

323. There is likely to be less impact for discretionary investment managers. Previous research implies that many discretionary investment managers already record their conversations<sup>141</sup> and this is supported by our survey results which show that a large proportion of DIMs already record their portfolio management business (ie they do not avail themselves of the current exemption). This however differs according to the size of the firm – whilst the majority of medium and large firms do not make use of the exemption, the opposite is the case for small firms (around 60 per cent of our sample of small firms do not currently tape their portfolio management business). DIMs that do currently tape would incur some incremental costs to comply with requirements under MiFID II. Those firms that do not currently tape would incur the full costs of implementing a taping system.

##### *Article 3 exempt firms*

324. Almost all the Article 3 firms responding to our survey do not currently tape calls, and we expect this to be the case across the majority of the population. Therefore they would incur the full costs of any new taping regime.

##### *Non-Directive firms*

325. The impact for non-Directive firms is likely to be less widespread. Previous research implies that many non-Directive firms who already record their conversations and communications have organisational requirements in place which align with those required to comply with MiFID II. As these firms already have a taping solution in place, the additional costs of meeting the MiFID II requirements would be low.

##### *Third country branches*

326. As these firms already have a taping solution in place, the additional costs of meeting the MiFID II requirements would be relatively low. Similar to non-Directive firms, we expect the additional costs to arise only in relation to extending the record retention period from six months to at least five years. However, as third party cloud storage costs have significantly decreased since we introduced our taping requirements, we expect the costs of adhering to the MiFID II taping requirements to be fairly minimal.

<sup>141</sup> According to a recent Thematic Review we undertook into asset managers' market abuse policies, the majority of firms recorded the fixed telephone lines of staff directly involved in the investment process with a minority also recording mobile phones. <http://www.fca.org.uk/static/documents/thematic-reviews/tr15-01.pdf>. p 9



**Direct costs**

- 327.** The greatest costs incurred by firms required to implement a taping system would be related to installing a new taping infrastructure. This would include one-off development costs (including service fees, connections, software and hardware) and ongoing costs, for example for ongoing taping, storage (assumed to be in a third party cloud) and *ex post* record retrieval. Our cost estimates include mobile recording as well as fixed recording, using a ratio of fixed users to mobile of 1:44. IT costs could also include monitoring software (eg word-recognition and search) and we have included this in our cost scenario.
- 328.** Other costs that firms would incur include one-off costs of policy development and on-going costs relating to compliance and staff training, and monitoring and surveillance. It is important to note however, that the organisational requirements should be applied in a proportionate manner, taking into account the size, nature and complexity of the firm and its business. Respondents to the CBA we undertook last year indicated that the costs for adhering to the new taping organisational requirements are likely to be minimal. We do not consider these new organisational requirements to be material.
- 329.** For those firms that already have a taping solution in place, the additional costs of meeting the MiFID II requirements would be relatively low. These would include one-off costs of compliance, policy development and staff training, and ongoing costs of additional monitoring. We have assumed that additional storage (from 6 months to 5 years) would be done via a third party cloud.
- 330.** We outline below the one-off and ongoing costs for firms undertaking corporate finance business or the service of portfolio management. Costs include fixed and mobile taping. Costs have been estimated for small, medium and large firms.
- 331.** Article 16(7) of MiFID also requires firms to record electronic communications. Electronic communications is not defined but includes, for example email and instant messaging. Firms have told us that they already have this infrastructure in place so there is unlikely to be any one-off costs associated with using this type of technology. On-going costs may arise with storing records for a period of five years and where requested by us, for a period of up to seven years. However, Schedule 1 of COBS currently outlines the record keeping retention period that firms must currently adhere to. In most cases it is already five years. We therefore consider it unlikely that firms will incur any additional costs in meeting the specific requirement to retain electronic communications for the scope of activities outlined in Article 16(7) for the retention period specified under MiFID II.
- 332.** Based on previous analysis when the FSA introduced the domestic requirement to tape and more recent data on the firms that we regulate, we estimate that the costs<sup>142</sup> of applying the taping requirements to discretionary investment managers will range between £2.5m – £5.0m for one-off costs and £2.4m – £4.7m for on-going costs..

<sup>142</sup> As illustration of how these costs arise we can consider an example of a firm needing to record the communication of one of its staff. Initial hardware, installation and first year storage capacity would cost, between £391 and £441 per individual (£335 for telephone lines and installation and £6 for the first year's storage capacity. If the lines are used on average 70% of an 8 hour working day and speech is recorded at between 13 and 16 kbits per second in WAV format. On that basis each line will generate about 40 mb of data. Across a 260-day working year the total data per user is 10.4 GB. Assuming that a backup copy is kept and this information is stored in a third party cloud, we estimate cost storage per user at £6 per year. We have also included between £50-100 per user per year for maintenance and other associated miscellaneous expenses including staff costs. Based on figures from previous analysis we estimate that for every landline recorded, there will be 0.44 mobile phones recorded. We estimate costs for the second and subsequent years will reduce to between £371 and £421 per user. However, we estimate that for firms that already record conversations and communications the largest expense will arise with retaining records from at least 6 months to a minimum of 5 years. We do not expect these storage costs to be material.



- 333.** We estimate based on the information that we hold for corporate finance business that the costs of applying the taping requirements to this category of firm will range between £3.2m – £3.6m for one-off costs and between £3m – £3.5m for on-going costs.

#### **Wider impacts**

- 334.** A number of firms responding to our survey noted that the requirements would have little wider impact beyond cost. Concerns were raised that costs could provide a barrier to competition with unregulated peers, particularly where other EU Member States used their discretion vis-à-vis portfolio management and the analogous regime differently. We considered the possibility of some firms who prefer a lesser regulatory approach exiting the UK market, however given the requirement to record portfolio management has been in place for a number of years and according to our survey results, the majority of discretionary investment managers have recording solutions in place, we do not expect such a potential impact. In relation to implementing an analogous regime, we do not envisage that there will be scope for significant inconsistencies in application across jurisdictions
- 335.** A number of firms had concerns about the risk of misuse of recorded information, in particular in relation to corporate finance business. They would need to ensure this information was even more closely protected than other information. It could lead to changes in business models for example more face-to-face client meetings and less information exchange over the phone. To the extent that this avoids information being recorded in as much detail or for as long a period as implied by the MiFID II standards, this could undermine the policy.

#### **Benefits**

- 336.** Estimating the benefits of taping is not reasonably practicable. However, in our view, access to tapes is useful when allegations of misselling arise. Access to tapes will provide a clear audit trail of the intention and understanding of the parties leading up to the conclusion of the transaction. We also see benefits in terms of the self-disciplining effect of taped calls ie when an advisor knows that the conversation is taped, they are more likely to adhere to their conduct of business obligations.
- 337.** Access to tapes will assist the FCA from a supervisory perspective. Indeed, the FCA has used tapes in a number of retail focused thematic reviews, including the thematic reviews into motor legal expenses insurance,<sup>143</sup> mobile phone insurance<sup>144</sup> and more recently this year's thematic into principals and their appointed representatives in the general insurance sector<sup>145</sup>. Therefore, the taping requirements will improve the regulatory toolkit available to us. We note that since 2010, there has been a general upward trend in the sales of investment products within the retail space. We expect this to rise further following recent changes to the pension and ISAs rules made in 2014 and the recent reduction in the Bank of England's base rate. Going forward, the tapes may provide further evidence for checking adherence to conduct of business obligations. We also expect an increase in the quality and volume of information available to the FCA for review.
- 338.** Our enforcement division has been listening to tapes since 2008 when the domestic requirement to tape relevant calls in wholesale markets came into effect. It is an important tool when undertaking investigations. Listening to tapes has proven to provide the most incriminating evidence in some of our cases. This is because we find that people tend to be more unguarded and less scripted on the phone than in written communications. We see many upsides to extending the requirement to tape to Article 3 firms, corporate finance business and removing

<sup>143</sup> <http://www.fca.org.uk/static/documents/thematic-reviews/tr13-01.pdf>

<sup>144</sup> <http://www.fca.org.uk/static/documents/thematic-reviews/tr13-02-mobile-phone-insurance.pdf>

<sup>145</sup> <https://www.fca.org.uk/static/documents/thematic-reviews/tr16-06.pdf>

the qualified exemption for discretionary investment managers. Access to tapes will provide the FCA with more evidence that may be relevant when establishing whether or not misconduct took place. This should improve our overall chances of getting the right enforcement outcome, particularly where the central issue in the case is who said what to whom and when poor record keeping is a problem. We have noted that even when the right records are kept, the client often disputes their content. However, access to tapes will close this evidence gap.

- 339.** We see benefits for consumers in requiring firms to record corporate finance business, portfolio management and removing the current exemption for discretionary investment managers. For example, consumers of these services will be able to request access to tapes when undertaking post-trade reconciliations or conducting their own internal deep-dives. More generally, enhancing existing taping requirements could potentially reduce consumer detriment through deterring occurrences of market abuse in the future.

## Supervision (SUP), authorisation and approved persons

### Introduction

- 340.** In this chapter of the CP we outline our proposals on how prospective MiFID firms should provide the information on members of the management body and on persons who effectively direct the business required under Article 4 of the Regulatory Technical Standards (RTS) under Article 7(4) of MiFID II ('Authorisations RTS') and Annex I and Annex II of the ITS under Article 7(5) of MiFID II ("Authorisations ITS"). Although most of this information is already captured in our existing forms, the Authorisations RTS and ITS require applicant MiFID firms to provide some additional information. The additional information requirements will be set in an EU Regulation, so we have no discretion and we have only carried out a high-level CBA for these requirements.

### Costs

- 341.** There will be costs of minimal significance for new firms deriving from the obligation to submit the new Form As. Firms will still have to submit the templates under the Authorisations ITS, but they will be able to cross-refer to the information provided in the new Form As. This will avoid any unnecessary duplication of the information provided by firms and any resulting costs.
- 342.** In addition, Article 3 firms should be subject, in accordance to Article 3 of MiFID II, to at least analogous requirements for authorisation as those applicable to MiFID firms. To meet this obligation we propose that Article 3 firms should use the new Form As when applying for authorisation. Since the additional information required under the Authorisations RTS, and reflected in the new Form As described in the Supervision Chapter of the CP, is not significantly different from that currently captured by our existing forms we expect that this will result only in costs of minimal significance for new applicant Article 3 firms.

### Benefits

- 343.** The proposals described in this chapter are in line with our consumer protection objective by ensuring that prospective applicant firms provide all the relevant information, required under MiFID II to assess the fitness and propriety of members of the management body or who direct the business, with their initial authorisation application. This will enable us to conduct a full assessment if the application and identify any potential risks to our statutory objectives.
- 344.** The proposed new Form As will also increase the likelihood that firms will submit complete applications. This has the potential of reducing the time required by the FCA to make a final determination on these applications and lowering barriers to entry. This will be particularly

important for firms who will have to be authorised by 3 January 2018 in order to continue to carry out their activities which will fall under the scope of MiFID II and avoid disruptions to their business.

### Perimeter guidance

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- 345.** The PERG amendments provide guidance on the regulatory perimeter rather than on FCA rules. The main implications of the changes in the regulatory perimeter which they provide guidance on were discussed in the Impact Assessment accompanying the Treasury's consultation on changes to legislation to implement MiFID II which included changes to ensure that the UK regulatory boundary captured all the activities and services encompassed by MiFID II and its range of financial instruments. The guidance does not impose additional costs on firms.

### Consequential changes to the Handbook

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- 346.** The changes we propose to the relevant modules of the Handbook are a direct result of the changes imposed by the implementation of MiFID II.
- 347.** In CP16/19, we set out our approach to the costs and benefits of implementing the proposed changes to SYSC arising from MiFID II, assuming the need to make these proposed consequential changes to the FCA Handbook. We do not believe these consequential changes will add any significant costs or benefits to those expected from MiFID II as assessed in CP16/19.
- 348.** The proposed consequential amendments are administrative and they do not reflect any change in policy. Most of them consist of incorporating cross-references to organisational requirements in the EU directly applicable regulation. There is no FSMA obligation on us to conduct a CBA or produce a compatibility statement for guidance.

# Annex 3

## Compatibility statement

### Compatibility with the FCA's general duties

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1. This annex follows the requirements set out in section 138I FSMA. When consulting on new rules, we are required by section 138I FSMA to include an explanation of why we consider the proposed rules are compatible with our strategic objective, advance one or more of our operational objectives, and have regard to the regulatory principles in section 3B FSMA. We are also required by section 138K(2) FSMA to state our opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons. We also note the application of section 139A (5) relating to consulting on guidance. This annex also includes our assessment of the equality and diversity implications of these proposals. Sections 1B (1) and 3B of FSMA require us to have regard to the regulatory principles.

### The FCA's objectives and regulatory principles

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2. Our proposals in this CP meet our strategic objective of ensuring that the relevant markets function well and are primarily intended to advance our operational objectives of:
  - enhancing market integrity, protecting and enhancing the integrity of the UK financial system, by implementing new standards for best execution, client order handling, personal transactions, and requirements for investment firm underwriting and placing
  - strengthening investor protection ensuring an appropriate degree of protection for consumers
  - promoting effective competition in the interests of consumers, by reinforcing best execution requirements, and ensuring different types of firm conducting the same investment business are subject to similar conduct rules.
3. In preparing our proposals, we have paid attention to the regulatory principles set out in section 3B FSMA. In particular:

#### **The desirability of exercising our functions in a way that recognises differences in the nature and objectives of businesses carried on by different persons.**

4. We do not believe that our proposals discriminate against any particular business model or approach. The treatment of third-country firms and Article 3 firms ensures a similar treatment of firms with different business models conducting similar business.

#### **The principle that we should exercise our functions as transparently as possible.**

5. We believe that by consulting on our proposals we are acting in accordance with this principle.

**The need to use our resources in the most efficient and economical way.**

6. For the proposals in this CP in the areas where we have discretion in implementing MiFID II we have had regard to the burden on us in assessing how best to implement.

**The principle that a burden or restriction should be proportionate to the benefits.**

7. We believe the proposals in this CP only invoke burdens or restrictions that are proportionate to the benefits.

**The desirability of publishing information relating to persons, or requiring persons to publish information.**

8. We have the power to publish information relating to investigations into firms and individuals. However, as set out in the Enforcement Guide (EG), we will not normally make public our investigations, findings or conclusions public, except in exceptional circumstances.

**Expected effect on mutual societies**

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9. Section 138K of FSMA requires us to state whether, in our opinion, our proposed rules have a significantly different impact on authorised mutual societies, compared to other authorised bodies. The relevant rules we propose to amend will apply, according to the powers exercised and to whom they are addressed, equally regardless of whether it is a mutual society or another authorised body.

**Equality and diversity**

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10. We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered.
11. Our equality impact assessment (EIA) suggests that our proposals do not result in direct discrimination for any of the groups with protected characteristics (ie age, disability, gender, pregnancy and maternity, race, religion and belief, sexual orientation and transgender), nor do we believe that our proposals should give rise to indirect discrimination against any of these groups. We welcome any comments respondents may have on any equality issues they believe may arise.

# Appendix 1

## Draft Handbook text

**MiFID 2 (CONDUCT OF BUSINESS, PRODUCT GOVERNANCE REQUIREMENTS  
AND MISCELLANEOUS PROVISIONS) INSTRUMENT 2017**

**Powers exercised**

- A. The Financial Conduct Authority makes this instrument in the exercise of:
- (1) the following powers and related provisions in the Financial Services and Markets Act 2000 (the “Act”):
    - (a) section 64A (Rules of conduct);
    - (b) section 69 (Statement of policy);
    - (c) section 137A (The FCA’s general rules);
    - (d) section 137B (FCA general rules: clients’ money, right to rescind etc);
    - (e) section 137R (Financial promotion rules);
    - (f) section 137T (General supplementary powers);
    - (g) section 138C (Evidential provisions);
    - (h) section 138D (Action for damages);
    - (i) section 138N (Temporary product intervention rules: statement of policy);
    - (j) section 139A (Power of the FCA to give guidance);
    - (k) section 247 (Trust scheme rules); and
    - (l) section 261I (Contractual scheme rules);
  - (2) regulation 6(1) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228); and
  - (3) in relation to the Glossary of definitions, the other rule and guidance making powers listed in Schedule 4 (Powers exercised) to the General Provisions of the FCA’s Handbook.
- B. The rule-making powers listed above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

**Commencement**

- C. This instrument comes into force on 3 January 2018.

**Amendments to the FCA Handbook**

- D. The modules of the FCA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2) below.

(1)	(2)
Glossary of definitions	Annex A
Senior Management Arrangements, Systems and Controls sourcebook	Annex B

(SYSC)	
Statements of Principle and Code of Practice for Approved Persons (APER)	Annex C
The Fit and Proper test for Approved Persons (FIT)	Annex D
Training and Competence (TC)	Annex E
General Provisions (GEN)	Annex F
Interim Prudential sourcebook for Investment Business (IPRU(INV))	Annex G
Conduct of Business sourcebook (COBS)	Annex H
Insurance: Conduct of Business sourcebook (ICOBS)	Annex I
Client Assets (CASS)	Annex J
Supervision manual (SUP)	Annex K
Decision Procedure and Penalties manual (DEPP)	Annex L
Consumer Credit sourcebook (CONC)	Annex M

**Making the Product Intervention and Product Governance sourcebook (PROD)**

- E. The Financial Conduct Authority makes the rules and gives guidance in Annex N to this instrument.

**Amendments to material outside the Handbook**

- F. The Perimeter Guidance manual (PERG) is amended in accordance with Annex O to this instrument.

**Notes**

- G. In the Annexes to this instrument, the “notes” (indicated by “**Note:**”) are included for the convenience of readers but do not form part of the legislative text.

**European Union Legislation**

- H. Although European Union legislation is reproduced in this instrument, only European Union legislation reproduced in the Official Journal of the European Union is deemed authentic.

**Citation**

- I. This instrument may be cited as the MiFID 2 (Conduct of Business, Product Governance Requirements and Miscellaneous Provisions) Instrument 2017.

By order of the Board  
[date] 2017



[*Editor's note:* The text in this Annex sets out new definitions, amended definitions and, for ease of reference where relevant, definitions that were consulted on as part of CP15/43 *Markets in Financial Instruments Directive II Implementation – Consultation Paper 1* (December 2015) and CP16/19 *Markets in Financial Instruments Directive II Implementation – Consultation Paper 2* (July 2016), where such definitions are referred to in the draft instrument. Definitions from CP15/43 and CP16/19 that are amended for the purposes of this consultation are preceded with an asterisk. The text in this Annex also takes into account the changes suggested by CP15/34 *Regulatory fees and levies: policy proposals for 2016/17* (October 2015) and CP16/18 *Changes to disclosure rules in the FCA Handbook to reflect the direct application of PRIIPs Regulation* (July 2016), as if they were made.]

## Annex A

### Amendments to the Glossary of definitions

Insert the following new definitions in the appropriate alphabetical position. The text in this section is not underlined.

<i>binary bet</i>	(in accordance with article [xx] of the <i>Regulated Activities Order</i> ) a derivative contract of a binary nature.
<i>commodity derivative</i>	those <i>financial instruments</i> defined in point (44)(c) of article 4(1) of <i>MIFID</i> which relate to: <ul style="list-style-type: none"> <li>(a) a <i>commodity</i>; or</li> <li>(b) an underlying referred to in Section C(10) of Annex I to <i>MIFID</i>; or in points (5), (6), (7) and (10) of Section C of Annex I to <i>MIFID</i>.</li> </ul> <p>[Note: article 2(1)(30) of <i>MiFIR</i>]</p>
<i>distribute</i>	offering, recommending or <i>selling</i> an <i>investment</i> or providing an <i>investment service</i> to a <i>client</i> . <p>[Note: recital 15 to the <i>MiFID Delegated Directive</i>]</p>
<i>distributor</i>	a <i>firm</i> which offers, recommends or <i>sells investments</i> or provides <i>investment services</i> to <i>clients</i> . <p>[Note: recital 15 to the <i>MiFID Delegated Directive</i>]</p>
<i>Emission Allowance Trading Directive</i>	Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community, and amending Council Directive 96/61/EC.

<i>end client</i>	the <i>person</i> or group of <i>persons</i> at the end of the supply chain.
<i>EU regulation</i>	a regulation made pursuant to article 288 of the <i>Treaty</i> .
<i>investment advice</i>	the provision of <i>personal recommendations</i> to a <i>client</i> , either upon the <i>client's</i> request or at the initiative of the <i>firm</i> , in respect of one or more transactions relating to <i>designated investments</i> .
<i>manufacture</i>	creating, developing, issuing and/or designing an <i>investment</i> , including when advising corporate <i>issuers</i> on the launch of new <i>investments</i> .  [Note: recital 15 to the <i>MiFID Delegated Directive</i> ]
<i>manufacturer</i>	a <i>firm</i> which creates, develops, issues, and/or designs <i>investments</i> , including when advising corporate <i>issuers</i> on the launch of new <i>investments</i> .  [Note: recital 15 to the <i>MiFID Delegated Directive</i> ]
<i>MiFID Delegated Directive</i>	Commission Delegated Directive (EU) [xxx/xxx] of [day/month/year] supplementing <i>MiFID</i> 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 ( <a href="http://ec.europa.eu/finance/securities/docs/isd/mifid/160407-delegated-directive_en.pdf">http://ec.europa.eu/finance/securities/docs/isd/mifid/160407-delegated-directive_en.pdf</a> ).
<i>MiFID, equivalent third country or optional exemption business</i>	business which is:  (1) <i>MiFID business</i> ; or  (2) the <i>equivalent business of a third country investment firm</i> ; or  (3) <i>MiFID optional exemption business</i> .
<i>MiFID optional exemption business</i>	<i>investment services and/or activities</i> and, where relevant, <i>ancillary services</i> carried on by a <i>MiFID optional exemption firm</i> .
<i>MiFID optional exemption firm</i>	a <i>firm</i> that complies with regulation 4(8) of the <i>MiFI Regulations</i> .
<i>MiFID Org Regulation</i>	Commission Delegated Regulation (EU) [xxx/xxx] of [day/month/year] supplementing <i>MiFID</i> of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive ( <a href="http://ec.europa.eu/finance/securities/docs/isd/mifid/160425-delegated-regulation_en.pdf">http://ec.europa.eu/finance/securities/docs/isd/mifid/160425-delegated-regulation_en.pdf</a> ).

<i>MiFID Org Regulation firm</i>	a <i>firm</i> to which the <i>MiFID Org Regulation</i> is directly applicable.
<i>MiFIR</i>	Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012.
<i>MiFI Regulations</i>	the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2016 (SI 2016/[xx]).
<i>*organised trading facility</i>	(in accordance with article 3(1) of the <i>Regulated Activities Order</i> ): <ul style="list-style-type: none"> <li>(a) an organised trading facility (within the meaning of article 4(1)(23) of <i>MiFID</i>) operated by an <i>investment firm</i>, a <i>credit institution</i> or a <i>market operator</i>; or</li> <li>(b) a facility which: <ul style="list-style-type: none"> <li>(i) is operated by an <i>investment firm</i>, a <i>credit institution</i> or a <i>market operator</i> which does not have a <i>Home State</i>; and</li> <li>(ii) if its operator had a <i>Home State</i>, would be an organised trading facility within the meaning of article 4(1)(23) of <i>MiFID</i>.</li> </ul> </li> </ul> <p>[Note: article 4(1)(23) of <i>MiFID</i>]</p>
<i>OTF</i>	<i>organised trading facility</i> .
<i>research</i>	research material or services: <ul style="list-style-type: none"> <li>(1) concerning one or several <i>financial instruments</i> or other assets; or</li> <li>(2) concerning the issuers or potential issuers of <i>financial instruments</i>; or</li> <li>(3) closely related to a specific industry or market such that it informs views on <i>financial instruments</i>, assets or issuers within that sector,</li> </ul> <p>and which explicitly or implicitly recommends or suggests an investment strategy and provides a substantiated opinion as to the present or future value or price of such instruments or assets, or otherwise contains analysis and original insights and reaches conclusions based on new or existing information that could be used to inform an investment strategy and be relevant and capable of adding value to the <i>firm's</i> decisions on behalf of <i>clients</i> being charged for that research.</p> <p>[Note: recital 28 to the <i>MiFID Delegated Directive</i>]</p>
<i>Securities Financing</i>	Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions

*Transactions Regulation* and of reuse and amending Regulation (EU) No 648/2012 (<http://eurlex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32015R2365>).

*temporary product intervention rule* a *rule* made under sections 137D and 138M of the *Act*.

*third country firm* (in *SYSC*) either:  
 (a) a *third country investment firm*; or  
 (b) the *UK* branch of a *non-EEA bank*.

Amend the following definitions as shown.

*advising on investments (except P2P agreements)* the *regulated activity*, specified in article 53(1) of the *Regulated Activities Order* (Advising on investments), which is in summary: advising a *person* if the advice is:

- (1) ...
- (2) advice on the merits of their doing any of the following (whether as principal or agent):
  - (a) *buying, selling*, subscribing for or underwriting a particular *investment* which is a *security* or *relevant investment* (that is, any *designated investment* (other than a *P2P agreement*), *funeral plan contract*, *pure protection contract*, *general insurance contract* ~~or~~ a right to or interests in a *funeral plan contract* or structured deposit);

...

*ancillary service* (1) (except in *CONC*) any of the services listed in Section B of Annex I to *MiFID*, that is:

- (a) safekeeping and administration of *financial instruments* for the account of *clients*, including custodianship and related services such as cash/collateral management but excluding maintaining securities accounts at the top tier level; ('central maintenance service') referred to in point 2 of section A of the Annex to CSDR;

...

*arranging (bringing about)* the *regulated activity*, specified in article 25(1) of the *Regulated Activities Order*, which is in summary: making arrangements for another *person*

*deals in investments* (whether as *principal* or agent) to *buy, sell*, subscribe for or underwrite a particular *investment* which is:

...

(e) *rights to or interests in investments* in (b), (c) or (d) ; or

(f) a structured deposit.

*branch*

(a) ...

(b) (in relation to an *investment firm*):

(i) a place of business other than the head office which is a part of an *investment firm*, which has no legal personality and which provides *investment services and/or activities* and which may also perform *ancillary services* for which the *firm* has been ~~authorized~~ authorised;

(ii) all the places of business set up in the same *EEA State* by an *investment firm* with headquarters in another *EEA State* are regarded as a single branch;

[Note: article ~~4(1)(26)~~ 4(1)(30) of *MiFID*]

...

*commodity*

(1) (except for (2) ~~and (3)~~) a physical asset (other than a financial instrument or cash) which is capable of delivery.

(2) (for the purpose of calculating *position risk requirements*) any of the following (but excluding gold):

(a) a commodity within the meaning of paragraph (1); and

(b) any:

(i) physical or energy product; or

(ii) of the items referred to in paragraph 10 of Section C of Annex 1 of the *MiFID* as an underlying with respect to the derivatives mentioned in that paragraph; which is, or can be, traded on a secondary market.

(3) ~~(in relation to the *MiFID Regulation*, including the definitions of a *financial instrument* and an *ancillary service*) (in relation to *MiFID* or *MiFIR*) any goods of a fungible nature that are capable of being delivered, including metals and their ores and alloys, agricultural products, and energy such as electricity, ~~not including services or other items that are not goods, such as currencies or rights in real estate, or that are entirely intangible.~~~~

[Note: ~~article 2(1) of the MiFID Regulation~~ article 2(6) of the MiFID Org Regulation]

*common platform firm*

- ...
- (c) a *UK MiFID investment firm* which falls within the definition of 'local firm' in ~~Article 3.1P of the Capital Adequacy Directive~~ article 4(1)(4) of the EU CRR; or

*common platform requirements*

- ...
- (1) SYSC 4 to SYSC 10; and
- (2) those articles of the MiFID Org Regulation as applied in accordance with SYSC 1 Annex 1 2.8AR, SYSC 1 Annex 1 3.2-AAAR, SYSC 1 Annex 1 3.2-AAR, SYSC 1 Annex 1 3.2CR and SYSC 1 Annex 1 3.3R.

*competent authority*

- ...
- (4) the authority, designated by each *EEA State* in accordance with ~~Article 48~~ article 67 of MiFID, unless otherwise specified in *MiFID*.

[Note: ~~article 4(1)(22)~~ 4(1)(26) of MiFID]

...

[Note: This definition is based on the definition contained in the CRD (Consequential Amendments) Instrument 2006 which was consulted on in the consultation paper Strengthening Capital Standards 2 (CP 06/3)]

*competent employees rule*

- (a) for a *firm* which is not a ~~common platform firm~~ any of (b) to (d) below, SYSC 3.1.6R ;
- (b) for a *common platform firm*, ~~SYSC 5.1.1R~~ article 21(1)(d) of the MiFID Org Regulation that applies in accordance with SYSC 1 Annex 1 2.8R and SYSC 1 Annex 1 2.8AR;
- (c) for a MiFID optional exemption firm and a third country firm, article 21(1)(d) of the MiFID Org Regulation that applies in accordance with SYSC 1 Annex 1 2.8R, SYSC 1 Annex 1 2.8AR and SYSC 1 Annex 1 3.2CR; and
- (d) for a UCITS firm, SYSC 5.1.1R.

*conflicts of interest policy*

- (1) (except in MAR 8) the policy established and maintained in accordance with SYSC 10.1.10R; and
- (2) (in *MAR 8*) the policy established and maintained in accordance with *MAR 8.2.8G* which;

(a) identifies circumstances that constitute, or may give rise to, a conflict of interest arising from *benchmark submissions* and the process of gathering information in order to make *benchmark submissions*; and

(b) sets out the process to manage such conflicts.

*consumer*

...

(7) (in the definitions of *cross-border dispute*, *domestic dispute*, *sales contract* and *service contract*, and in DISP 1.1A.37R, DISP 2.7.3R and DISP 2.7.9AR) has the meaning in regulation 3 of the *ADR Regulations*, which is an individual acting for purposes which are wholly or mainly outside that individual's trade, business, craft, or profession.

[Note: article 4(1) of the *ADR Directive*]

...

*dealing in investments as agent*

the *regulated activity*, specified in article 21 of the *Regulated Activities Order* (Dealing in investments as agent), which is in summary: *buying*, *selling*, subscribing for or underwriting *designated investments* (other than *P2P agreements*), *pure protection contracts* ~~or~~ *general insurance contracts* or structured deposits as agent.

*designated investment*

a *security* or a contractually-based investment (other than a *funeral plan contract* and a right to or interest in a *funeral plan contract*), that is, any of the following *investments*, specified in Part III of the *Regulated Activities Order* (Specified Investments):

...

(h) *stakeholder pension scheme* (article 82(1));

(ha) ...

(hb) *emissions auction product* (article 82A) where it is a *financial instrument*;

(hc) *emission allowance* (article 82B);

...

*designated investment business*

any of the following activities, specified in Part II of the *Regulated Activities Order* (Specified Activities), which is carried on by way of business:

...

(da) ...

(daa) operating an organised trading facility (article 25DA):

...

*distribution channels*

a channel through which information is, or is likely to become, publicly available. Information which is "likely to become publicly available" means information to which a large number of *persons* have access.

[~~Note: article 2(1) of the MiFID implementing Directive~~]

*durable medium*

- (a) paper; or
- (b) any instrument which enables the recipient to store information addressed personally to him or her in a way accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored. In particular, *durable medium* covers floppy disks, CD-ROMs, DVDs and hard drives of personal computers on which electronic mail is stored, but it excludes ~~Internet~~ internet sites, unless such sites meet the criteria specified in the first sentence of this paragraph. (~~in~~ In relation to ~~MiFID or equivalent third country business~~ the equivalent business of a third country investment firm, MiFID optional exemption business or collective portfolio management, if the relevant rule derives from the MiFID Org Regulation or implements the MiFID implementing Directive, the UCITS Directive, the UCITS implementing Directive or the UCITS implementing Directive No 2) the instrument used must be:
- (i) appropriate to the context in which the business is to be carried on; and
- (ii) specifically chosen by the recipient when offered the choice between that instrument and paper.

For the purposes of this definition, the provision of information by means of electronic communications shall be treated as appropriate to the context in which the business between the *firm* and the *client* is, or is to be, carried on if there is evidence that the *client* has regular access to the internet. The provision by the *client* of an e-mail address for the purposes of the carrying on of that business is sufficient.

[~~Note: article 2(f) of, and Recital 20 of to, the Distance Marketing Directive, article 2(12) of the Insurance Mediation Directive, articles 2(2), 3(1) and 3(3) of the MiFID implementing Directive, articles 75(2) and 81(1) of the UCITS Directive, article 20(3) of the UCITS implementing Directive and article 7 of the UCITS implementing Directive No 2~~]

~~\*emissions~~

- (1) an 'allowance', within the meaning of article 3(a) of ~~Directive~~



*emission allowance*

~~2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC the *Emission Allowance Trading Directive*;~~

(2) (in relation to *MiFID business* other than in *MAR 10 (Commodity Derivative Position Limits and Controls and Position Reporting)*) the *investment*, specified in article 82B of the *Regulated Activities Order* ('Emission Allowances'), which is in summary emission allowances:

(a) consisting of any units recognised for compliance with the *Emission Allowance Trading Directive*; and

(b) to which article 82B of the *Regulated Activities Order* applies; and

(3) (in *MAR 10 (Commodity Derivative Position Limits and Controls and Position Reporting)*):

(a) an allowance consisting of any units recognised for compliance with Directive 2003/87/EC (Emission Trading Scheme), as specified in paragraph (11) of Section C of Annex I of *MiFID*; or

(b) any *derivative* of such an allowance, whether falling under paragraph (4) or (10) of Section C of Annex I of *MiFID*.

*execution of orders on behalf of clients*

acting to conclude agreements to buy or sell one or more *financial instruments* on behalf of *clients* including the conclusion of agreements to sell *financial instruments* issued by an *investment firm* or a *credit institution* at the moment of their issuance.

[Note: article 4 (1)(5) of *MiFID*]

*financial analyst*

...

[Note: article ~~2(4) of the *MiFID implementing Directive*~~ 2(1) of the *MiFID Org Regulation*]

*financial instrument*

(1) ...

(d) options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, emission allowances, or other derivative instruments, financial indices or financial measures which may be settled physically or in cash;

(da) (in relation to derivative contracts relating to a currency) has the meaning in article 10 [link to follow] of the *MiFID Org*

Regulation) (in summary):

- (i) an instrument which is not a contract within the meaning of paragraph 2 of that article; or
- (ii) a means of payment as described in paragraph 1(b) of that article;
- (e) options, futures, swaps, ~~forward rate agreements~~ forwards and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (~~otherwise~~ other than by reason of default or other termination event );
- (f) options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or an MTF, an MTF or an OTF, except for wholesale energy products (having regard to article 6 of the MiFID Org Regulation) traded on an OTF that must be physically settled where the conditions of article 5 of the MiFID Org Regulations are met;
- (g) options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in (f) and :
  - (i) not being for commercial purposes ; having regard to article 7(4) of the MiFID Org Regulation;
  - (ii) which have the characteristics of other derivative financial instruments ; ~~having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls (see article 38(1), (2) and (4) of the MiFID Regulation)~~ having regard to article 7(1) of the MiFID Org Regulation; and
  - (iii) not being spot contracts having regard to articles 7 (1) and (2) of the MiFID Org Regulation;
- ...
- (j) options, futures, swaps, forward rate agreements and any other derivative contracts relating to:
  - (i) climatic variables;
  - (ii) freight rates;
  - (iii) emission allowances;

- (iv) inflation rates or other official economic statistics;
- (v) telecommunications bandwidth;
- (vi) commodity storage capacity;
- (vii) transmission or transportation capacity relating to commodities, whether cable, pipeline or other means;
- (viii) an allowance, credit, permit, right or similar asset which is directly linked to the supply, distribution or consumption of energy derived from renewable resources;
- (ix) a geological, environmental or other physical variable;
- (x) any other asset or right of a fungible nature, other than a right to receive a service, that is capable of being transferred;
- (xi) an index or measure related to the price or value of, or volume of transactions in any asset, right, service or obligation;
- (xii) a derivative contract to which article 8 of the *MiFID Org Regulation* applies;

where the conditions in articles ~~38~~ 7(3) and (4) of the ~~*MiFID Regulation*~~ *MiFID Org Regulation* are met;

[Note: article ~~4(1)(17)~~ 4(1)(15) and section C of Annex I to *MiFID* and ~~articles 38 and 39 of the *MiFID Regulation*~~ articles 7 and 8 of the *MiFID Org Regulation*]

- (k) emission allowances consisting of any units recognised for compliance with the *Emission Allowance Trading Directive*;

*financial promotion*

- (1) ...
- (2) (in relation to *COBS* 3.2.1R(3), *COBS* 4.3.1R, *COBS* 4.5.8R and *COBS* 4.7.1R) (in addition to (1)) a marketing communication within the meaning of *MiFID* made by a *firm* in connection with its ~~*MiFID or equivalent third country business*~~. *MiFID, equivalent third country or optional exemption business*.
- (3) ...

*firm*

...

- (8) (in SYSC 18, with the exception of ~~the guidance in SYSC 18.3.9G and SYSC 18.6~~):
- (a) A UK relevant authorised person except a small deposit taker; and
  - (b) a firm as referred to in Chapter 1.1 of the PRA Rulebook: Solvency II Firms: Whistleblowing.

*independent advice* a ~~personal recommendation to a retail client in relation to a retail investment product~~ *client* where the *personal recommendation* provided meets the requirements of the *rule* on independent advice (COBS 6.2B.9R).

*investment firm* (1) any ~~person~~ *person* whose regular occupation or business is the provision of one or more *investment services* to third parties and/or the performance of one or more investment activities on a professional basis.

[Note: article 4(1)(1) of *MiFID*]

...

*investment research* ~~research or other information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers of financial instruments, including any opinion as to the present or future value or price of such instruments, intended for distribution channels or for the public, and in relation to which the following conditions are met:~~

~~(a) it is labelled or described as investment research or in similar terms, or is otherwise presented as an objective or independent explanation of the matters contained in the recommendation;~~

~~(b) if the recommendation in question were to be made by an investment firm to a client, it would not constitute the provision of a personal recommendation.~~

as defined in article 36(1) of the *MiFID Org Regulation*.

[Note: article ~~24(1)~~ 36(1) of the *MiFID implementing Directive Org Regulation*]

*investment service* any of the following involving the provision of a service in relation to a *financial instrument*:

...

(h) operation of ~~multilateral trading facilities~~; an MTF;

(i) operation of an OTF.

[Note: article 4(1)(2) of, and section A of Annex 1 to, *MiFID* and article

	6(5) of the <i>auction regulation</i> ]
<i>investment services and/or activities</i>	<p>any of the services and activities listed in Section A of Annex I to <i>MiFID</i> relating to any <i>financial instrument</i>, that is:</p> <p>...</p> <p>(h) operation of <del><i>multilateral trading facilities</i></del>; <u>an <i>MTF</i></u>; and</p> <p>(i) <u>operation of an <i>OTF</i></u>.</p> <p>[Note: article 4(1)(2) of, and section A of Annex 1 to, <i>MiFID</i> and article 6(5) of the <i>auction regulation</i>]</p>
<i>limit order</i>	<p>an order to buy or sell a <i>financial instrument</i> at its specified price limit or better and for a specified size.</p> <p>[Note: article 4(1)(16) <del>4(1)(14)</del> of <i>MiFID</i>]</p>
<i>local firm</i>	<p><del>a <i>firm</i> which falls within the definition of "local firm" in Article 3.1P of <i>CAD</i>, that is a firm dealing for its own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets, or dealing for the accounts of other members of those markets and being guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such a firm is assumed by clearing members of the same markets</del></p> <p><u>has the meaning in article 4(1)(4) of the <i>EU CRR</i>.</u></p>
<i>making arrangements with a view to transactions in investments</i>	<p>the <i>regulated activity</i>, specified in article 25(2) of the <i>Regulated Activities Order</i> (Arranging deals in investments), which is in summary: making arrangements with a view to a <i>person</i> who participates in the arrangements <i>buying, selling</i>, subscribing for or underwriting any of the following <i>investments</i> (whether as <i>principal</i> or agent):</p> <p>...</p> <p>(f) ...</p> <p>(g) a <i>general insurance contract</i>; <u>or</u></p> <p>(h) <u>a <i>structured deposit</i></u>.</p>
<i>management body</i>	<p>(1) (other than in (2)) (in accordance with article 3(7) of <i>CRD</i> <u>and article 4.1(36) of <i>MiFID</i></u>) the <i>governing body</i> and <i>senior personnel</i> <del>of a <i>CRR firm</i></del> who are empowered to set <del>the</del> <u>a <i>firm</i>'s</u> strategy, objectives and overall direction, and which oversee and monitor management decision-making <u>in the following</u>:</p> <p>(a) <u>a <i>CRR firm</i></u>; or</p>

- (b) a common platform firm (in relation to the requirements imposed by or under MiFID or MiFIR).
- (2) (in *COLL* and in *SYSC* 19E and in accordance with article 2(1)(s) of the *UCITS Directive*), the *governing body* of a *management company* or *depository* of a *UCITS scheme* or an *EEA UCITS scheme*, as applicable, with ultimate decision-making authority comprising the supervisory and the managerial function or only the managerial function, if the two functions are separated.
- managing investments* the *regulated activity*, specified in article 37 of the *Regulated Activities Order* (Managing investments), which is in summary: managing assets belonging to another *person* in circumstances which involve the exercise of discretion, if:
- (a) the assets consist of or include any *security* or *contractually based investment* (that is, any *designated investment* (other than a *P2P agreement*), *funeral plan contract*, *structured deposit* or right to or interest in a *funeral plan contract*); or
- (b) ...
- MiFID* ~~The European Parliament and Council Directive on markets in financial instruments (No. 2004/39/EC).~~
- ~~See also *MiFID Regulation* and *MiFID implementing Directive*.~~
- Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending the *insurance mediation directive* and *AIFMD*.
- \**MiFID investment firm* (1) (in summary) ~~(except in *SUP 13*, *SUP 13A* and *SUP 14* in relation to notification of *passport activity*)~~ a firm to which *MiFID* applies including, for some purposes only, a *credit institution* and *collective portfolio management investment firm*.
- (2) (in full) ~~(except in *SUP 13*, *SUP 13A* and *SUP 14* in relation to notification of *passport activity*)~~ a firm which is:
- ~~(1)~~ (a) an *investment firm* with its head office in the *EEA* (or, if it has a registered office, that office);
- ~~(2)~~ (b) a *CRD credit institution* (only when providing an *investment service or activity* or when selling, or advising *clients* in relation to, *structured deposits* in relation to:
- (i) the *rules* implementing the ~~Articles~~ articles referred to in ~~Article 1(2)~~ article 1(3) and article 1(4) of *MiFID*);
- (ii) the requirements imposed upon it by and under *MiFIR*; and

(iii) the requirements imposed upon it by EU regulations made under MiFID;

- ~~(3)~~ a *collective portfolio management investment firm* (only  
 (c) when providing the services referred to in article 6(4) AIFMD or ~~Article~~ article 6(3) of the UCITS Directive in relation to the *rules* implementing the articles of MIFID referred to in article 6(6) of AIFMD or ~~Article~~ article 6(4) of the UCITS Directive and for a *full-scope UK AIFM* or the rules implementing article 12(2)(b) of AIFMD);

unless, and to the extent that, *MiFID* does not apply to it as a result of ~~Article~~ article 2 (Exemptions) or Article article 3 (Optional exemptions) of *MiFID*.

- (3) (in SUP 13, SUP 13A and SUP 14 in relation to notification of passported activity) an investment firm with its head office in the EEA (or, if it has a registered office, that office) unless, and to the extent that, MiFID does not apply to it as a result of article 2 (Exemptions) or article 3 (Optional exemptions) of MiFID.

*multilateral trading facility*

a multilateral system, operated by an *investment firm* or a *market operator*, which brings together multiple third-party buying and selling interests in *financial instruments* – in the system and in accordance with non-discretionary rules – in a way that results in a contract in accordance with ~~the provisions of~~ Title II of *MIFID*.

[Note: ~~article 4(1)(15)~~ 4(1)(22) of *MiFID*]

*non-independent research*

~~an investment recommendation which:~~

~~(a) relates to *financial instruments* (as specified in Section C of Annex 1 of *MiFID*, whether or not they are admitted to trading on a *regulated market*); and~~

~~(b) does not constitute *investment research*.~~

an investment recommendation that does not meet the conditions set out in article 36(1) of the *MiFID Org Regulation*.

[Note: ~~article 24(2)~~ 36(1) of the ~~*MiFID implementing Directive*~~ *MiFID Org Regulation*]

*option*

the *investment*, specified in article 83 of the *Regulated Activities Order* (Options), which is in summary an option to acquire or dispose of:

- (a) a *designated investment* (other than a *P2P agreement*, an option or one to which (d) or (e) applies); or

...

*periodic*

a report which a *firm* is required to provide to a *client* ~~under~~ pursuant to:

- statement*
- (a) COBS 16.3 (Periodic reporting) where the *firm* is carrying on designated investment business other than any *MiFID*, equivalent third country or optional exemption business;
  - (b) article 60(1) of the *MiFID Org Regulation* where the *firm* is carrying on *MiFID* business;
  - (c) GEN 2.2.22AR and COBS 16A.4.1EU where the *firm* is carrying on the equivalent business of a third country investment firm;
  - (d) COBS 16A.1.2R and COBS 16A.4.1EU where the *firm* is carrying on optional exemption business.
- [Note: see COBS 16A.4.1EU where article 60(1) of the *MiFID Org Regulation* is reproduced]
- personal recommendation*
- (1) (except in *CONRED*) a recommendation that is *advice on investments, advice on conversion or transfer of pension benefits, or advice on a home finance transaction* and is presented as suitable for the person to whom it is made, or is based on a consideration of the circumstances of that person.
- A recommendation is not a personal recommendation if it is issued exclusively through distribution channels or to the public.
- For the purposes of this definition, references in the *Handbook* to making *personal recommendations* on, or in relation to, *P2P agreements* should be understood as referring to making *personal recommendations* involving *advice on P2P agreements*.
- [Note: article 52 9 of the ~~*MiFID implementing Directive*~~ *MiFID Org Regulation*]
- (2) (in *CONRED*) ...
- regulated market*
- (1) a multilateral system operated and/or managed by a *market operator*, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in *financial instruments* – in the system and in accordance with its nondiscretionary rules – in a way that results in a contract, in respect of the *financial instruments* admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with ~~the provisions of~~ Title III of *MiFID*.
- [Note: article ~~4(1)(14)~~ 4(1)(21) of *MiFID*]
- ...
- regulatory system*
- the arrangements for regulating a *firm* or other *person* in or under the *Act*, including the *threshold conditions*, the *Principles* and other *rules*, the *Statements of Principle*, codes and *guidance*, or in or under the *CCA*, and including any relevant directly applicable provisions of a Directive or



Regulation such as those contained in the ~~MiFID implementing Directive~~, the ~~MiFID Regulation~~, MiFID Org Regulation and the *EU CRR*.

- relevant person*
- (1) (in *COMP*) a person for claims against whom the *compensation scheme* provides cover, as defined in *COMP* 6.2.1R;
  - (2) (otherwise) any of the following:
    - (a) a *director, partner* or equivalent, manager or *appointed representative* (or where applicable, *tied agent*) of the *firm*;
    - (b) a *director, partner* or equivalent, or manager of any *appointed representative* (or where applicable, *tied agent*) of the *firm*;
    - (c) an *employee* of the *firm* or of an *appointed representative* (or where applicable, *tied agent*) of the *firm*; as well as any other natural person whose services are placed at the disposal and under the control of the *firm* or an *appointed representative* or a *tied agent* of the *firm* and who is involved in the provision by the *firm* of *regulated activities*;
    - (d) a natural person who is directly involved in the provision of services to the *firm* or its *appointed representative* (or where applicable, *tied agent*) under an *outsourcing* arrangement or (in the case of a *management company*) a delegation arrangement to third parties, for the purpose of the provision by the *firm* of *regulated activities* or (in the case of a *management company*) *collective portfolio management*.

[Note: ~~article 2(3) of the MiFID implementing Directive~~ article 2(1) of the MiFID Org Regulation and article 3(3) of the *UCITS implementing Directive*]

- \*remuneration*
- (1) (except where (2) applies) any form of remuneration, including salaries, *discretionary pension benefits* and benefits of any kind.

[Note: article 92(2) of *CRD*]

- (2) (in relation to those articles of the MiFID Org Regulation as applied in accordance with SYSC 1 Annex 1 2.8AR, SYSC 1 Annex 1 3.2-AAR, SYSC 1 Annex 1 3.2-AAAR, SYSC 1 Annex 1 3.2CR, SYSC 1 Annex 1 3.3R; SYSC 19F.1.3R; SYSC 19F.1.4R and SYSC 19F.1.5R, and in PROD 3) all forms of payments or financial or non-financial benefits provided directly or indirectly by a *firm* to *relevant persons* in the provision of one or more of *designated investment business*, ~~and~~ *ancillary activities* and *ancillary services* to *clients*.

[Note: article 2(5) of the *MiFID Org Regulation*]

- restricted advice* (a) a ~~personal recommendation to a retail client in relation to a retail investment product~~ client which is not *independent advice*; or
- (b) *basic advice*.
- securities financing transaction* (1) (in ~~COBS, in CASS~~) an instance of stock lending or stock borrowing or the lending or borrowing of other *financial instruments*, a repurchase or reverse repurchase transaction, or a buy-sell back or sell-buy back transaction.
- [~~Note: article 2(10) of the MiFID Regulation~~]
- (1A) ...
- (1B) (in CASS) transactions defined in article 3(11) of the securities financing transaction regulation.
- [~~Note: article 1(3) of the MiFID Delegated Directive~~]
- (2) (in any other case) any of the following:
- (a) a *repurchase transaction*; or
- (b) a *securities or commodities lending or borrowing transaction*; or
- (c) a *margin lending transaction*.
- senior management* (1) ...
- (2) (~~in~~ In SYSC (except SYSC 4.3A) and IFPRU and in accordance with article 3(9) of *CRD*) those *persons* who are a natural person and who exercise executive functions in an *institution* and who are responsible and accountable to the *management body* for the day-to-day management of the *institution*.
- (3) (In SYSC 4.3A and COBS 2.3B and in accordance with article 4.1(37) of MiFID) those persons who are a natural person, who exercise executive functions in common platform firms and who are responsible and accountable to the management body for the day-to-day management of the firm, including for the implementation of the policies concerning the distribution of services and products to clients by it and its personnel.
- structured deposit* ~~a deposit paid on terms under which any interest or premium will be paid, or is at risk, according to a formula which involves the performance of:~~
- (a) ~~an index (or combination of indices) (other than money market indices);~~
- (b) ~~a stock (or combination of stocks); or~~

(e) ~~a commodity (or combination of commodities).~~

(in accordance with article 3 of the *Regulated Activities Order*) a deposit which is fully repayable at maturity on terms under which interest or a premium will be paid or is at risk, according to a formula involving factors such as:

- (a) an index or combination of indices, excluding variable rate deposits whose return is directly linked to an interest rate index such as EURIBOR or LIBOR; or
- (b) a financial instrument or combination of financial instruments; or
- (c) a commodity or combination of commodities or other physical or non-physical non-fungible assets; or
- (d) a foreign exchange rate or combination of foreign exchange rates.

[Note: article 4(1)(43) of *MiFID*]

*suitability report* a report which a *firm* must provide to its *client* ~~under COBS 9.4 (suitability reports)~~ which, among other things, explains why the *firm* has concluded that a recommended transaction is suitable for the *client* and which is provided pursuant to:

- (a) COBS 9.4 (suitability reports) where the *firm* is carrying on designated investment business other than any *MiFID*, equivalent third country or optional exemption business;
- (b) article 54(12) of the *MiFID Org Regulation* where the *firm* is carrying on *MiFID* business;
- (c) GEN 2.2.22AR and COBS 9A.3.3EU where the *firm* is carrying on the equivalent business of a third country investment firm;
- (d) COBS 9A.1.2R and COBS 9A.3.3EU where the *firm* is carrying on optional exemption business.

[Note: article 4(1)(43) of *MiFID*]

*third country investment firm* a *firm* which would be a *MiFID investment firm* if it had its head office or registered office in the *EEA*.

*third party prospectus* a communication made by a *firm* if the communication is a prospectus that has been drawn up and published in accordance with the *Prospectus Directive* and the *firm* is not responsible under that directive for the information given in the prospectus.

[Note: recital 52 73 to the *MiFID implementing Directive MiFID Org Regulation*]

<i>trading venue</i>	<p>(1) (except in <i>FINMAR</i> and <i>MAR</i>) a <i>regulated market</i>, <u>an MTF</u> or <i>systematic internaliser</i> acting in its capacity as such, and, where appropriate, a system outside the <i>EU</i> with similar functions to a <i>regulated market</i> or <i>MTF</i>;</p> <p><del>[Note: article 2(8) of the <i>MIFID Regulation</i>]</del></p> <p>(2) (in <i>FINMAR</i>) (as defined in article 2(1)(1) of the <i>short selling regulation</i>) a <i>regulated market</i> or an <i>MTF</i>.</p> <p>(3) (in <i>MAR</i>) a <i>regulated market</i>, <del>or</del> an <i>MTF</i> <u>or an <i>OTF</i></u>.</p> <p><u>[Note: article 4(1)(24) of <i>MiFID</i>].</u></p>
<i>transaction</i>	<p>(1) (except in <i>CONC</i> App 1.1 <u>and <i>SUP 17</i></u>) only the purchase and sale of a <i>financial instrument</i>. <del>For the purposes of the <i>MiFID Regulation</i>, excluding Chapter II, this does not include: ;</del></p> <p style="margin-left: 20px;">(a) <del><i>securities financing transactions</i>; or</del></p> <p style="margin-left: 20px;">(b) <del>the exercise of options or covered warrants; or</del></p> <p style="margin-left: 20px;">(c) <del>primary market transactions (such as issuance allotment or subscription) in <i>financial instruments</i> falling within Article 4(1)(18)(a) and (b) of <i>MiFID</i>.</del></p> <p>(2) (in <i>CONC</i> App 1.3, except in <i>CONC</i> App 1.1.6R(1)(c)) a <i>credit agreement</i>, any transaction which is a <i>linked transaction</i>, any contract for the provision of <i>security</i> relating to the <i>credit agreement</i>, any <i>credit broking</i> contract relating to the <i>credit agreement</i> and any other contract to which the <i>borrower</i> or a <i>relative</i> of his is a party and which the <i>lender</i> requires to be made or maintained as a condition of the making of the <i>credit agreement</i>;</p> <p><del>[Note: article 5 of the <i>MiFID Regulation</i>]</del></p> <p>(3) <u>(in <i>SUP 17</i>) a concluded acquisition or disposal of a <i>reportable financial instrument</i>, including those in articles 2(2) to 2(4) of <i>RTS 22</i>, but excluding those in article 2(5) of that Regulation.</u></p>
<i>UCITS management company</i>	<p>...</p> <p>(2) ...</p> <p><del>[Note: article 4(1)(24) <u>article 4(1)(28)</u> of <i>MiFID</i>]</del></p>
<i>website conditions</i>	<p>the following conditions:</p> <p>...</p>

[Note: article 3 of the ~~MiFID implementing Directive~~ MiFID Org Regulation and article 38(2) of the KII Regulation]

Delete the following definitions.

<i>common platform outsourcing rules</i>	SYSC 8.1.1R to SYSC 8.1.12G.
<i>local</i>	<p>(1) (except in <i>IFPRU</i> 1.1 (Application and purpose)) a <i>firm</i> which is a member of a <i>futures</i> and <i>options</i> exchange and whose <i>permission</i> includes a <i>requirement</i> that:</p> <p style="margin-left: 20px;">(a) the <i>firm</i> will not conduct <i>designated investment business</i> other than:</p> <p style="margin-left: 40px;">(i) <i>dealing</i> for its own account on that <i>futures</i> or <i>options</i> exchange; or</p> <p style="margin-left: 40px;">(ii) <i>dealing</i> for the accounts of other members of the same <i>futures</i> and <i>options</i> exchange; or</p> <p style="margin-left: 40px;">(iii) making a price to other members of the same <i>futures</i> and <i>options</i> exchange; and</p> <p style="margin-left: 40px;">(iv) <i>dealing</i> for its own account in financial <i>futures</i> and <i>options</i> or other <i>derivatives</i> in the capacity of a customer; and</p> <p style="margin-left: 20px;">(b) The performance of the <i>firm</i>'s contracts must be guaranteed by and must be the responsibility of one or more of the clearing members of the same <i>futures</i> and <i>options</i> exchange.</p> <p>(2) [deleted]</p> <p>(3) (in <i>IFPRU</i> 1.1 (Application and purpose) has the meaning given in the definition of "local firm" in article 4(1)(4) of the <i>EU CRR</i>.</p>
<i>MiFID II</i>	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending the <i>insurance mediation directive</i> and <i>AIFMD</i> ( <a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?url=OJ:JOL_2014_173_R_0009&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?url=OJ:JOL_2014_173_R_0009&amp;from=EN</a> ).
<i>MiFID implementing Directive</i>	Commission Directive No. 2006/73/EC implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined

terms for the purposes of that Directive.

*MiFID  
outsourcing  
rules*

*SYSC 8.1.1R to SYSC 8.1.11R.*

## Annex B

**Amendments to the Senior Management Arrangements, Systems and Controls  
sourcebook (SYSC)**

In this Annex, underlining indicates new text and striking through indicates deleted text, unless indicated otherwise.

**1 Annex 1 Detailed application of SYSC**

...

<b>Part 3</b>	<b>Tables summarising the application of the common platform requirements to different types of firm</b>	
3.1	G	...
...		

...

Table A: Application of the common platform requirements in SYSC 4 to SYSC 10

...

<b>Provision SYSC 5</b>	<b>COLUMN A Application to a common platform firm other than to a UCITS investment firm</b>	<b>COLUMN A+ Application to a UCITS management company</b>	<b>COLUMN A++ Application to a full-scope UK AIFM of an authorised AIF</b>	<b>COLUMN B Application to all other firms apart from insurers, managing agents, the Society, and full-scope UK AIFMs of unauthorised AIFs, MiFID optional exemption firms and third country firms</b>
...	...	...	...	...
SYSC 5.1.5AG	...	...	...	...
<u>SYSC</u> <u>5.1.5AAR</u>	<u>Rule</u>	<u>Not applicable</u>	<u>Not applicable</u>	<u>Not applicable</u>
...				

...

Table B: Application of the common platform requirements in SYSC 4 to 10 to MiFID optional exemption firms and third country firms

Provision	COLUMN A MiFID optional exemption firms	COLUMN B Third country firms
...		
SYSC 5	...	...
...	...	...
SYSC 5.1.5AG	...	...
<u>SYSC 5.1.5AAR</u>	<u>Not applicable</u>	<u>Rule</u>

...

**5 Employees, agents and other relevant persons**

**5.1 Skills, knowledge and expertise**

...

Application to a common platform firm

5.1.1-AA G For a *common platform firm*:

- (1) ...
- (2) The *rules* and *guidance* apply as set out in the table below:

Subject	Applicable rule or guidance
Segregation of functions – <u>knowledge and competence</u>	SYSC 5.1.2G to SYSC 5.1.5AG, <u>SYSC 5.1.5 AAR</u> , SYSC 5.1.7R, SYSC 5.1.8G to SYSC 5.1.11G
...	

Segregation of functions – knowledge and competence

...

5.1.5A G ...

5.1.5AA R This rule applies to a common platform firm:



- (1) in relation to its *MiFID* or equivalent third country business;
- (2) in respect of any *natural persons* (“relevant individuals”) who, on behalf of the *firm*:
  - (a) make *personal recommendations* to *clients* in relation to *financial instruments* or *structured deposits*; or
  - (b) provide information to *retail clients* or *professional clients* about *financial instruments*, *structured deposits*, *investment services* or *ancillary services*.

[**Note:** article 25(1) of *MiFID*]

5.1.5AB    G    A *firm* must ensure, and be able to demonstrate to the *FCA*, at the *FCA*’s request, that any relevant individuals possess the necessary knowledge and competence so as to ensure that the *firm* is able to meet its obligations under:

- (1) those rules which implement articles 24 and 25 of *MiFID* (including those which implement related provisions under the *MiFID Delegated Directive*); and
- (2) related provisions under the *MiFID Org Regulation*.

5.1.5AC    G    The *rules* which implement articles 24 and 25 of *MiFID* can be found in *COBS* and *PROD* and are identified with a ‘Note:’.

5.1.5AD    G    *ESMA* has issued guidelines for *MiFID investment firms* specifying the criteria for the assessment of knowledge and competence for the purposes of *SYSC 5.1.5AAR*. The *ESMA* guidelines (published on 17 December 2015) can be found at <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-translations-its-guidelines-assessment-knowledge-and-competence>.

5.1.5AE    G    A *firm* to which the Training and Competence sourcebook (*TC*) applies may satisfy its obligations under *SYSC 5.1.5AAR* in relation to an *employee* by way of compliance with its obligations in *TC*.

...

After SYSC 10 (Conflicts of interest) insert the following new section. All the text is new and is not underlined.

## **10A            Recording telephone conversations and electronic communications**

### **10A.1        Application**

Application

- 10A.1.1 R Subject to the exemptions in SYSC 10A.1.4R, this chapter applies to a *firm*:
- (1) that is a:
    - (a) *UK MiFID investment firm*; or
    - (b) *full-scope UK AIFM*; or
    - (c) *small authorised UK AIFM* or *residual CIS operator*; or
    - (d) *incoming EEA AIFM*; or
    - (e) *UCITS management company*; or
    - (f) *MiFID optional exemption firm*; or
    - (g) *EEA MiFID investment firm*; or
    - (h) *third country investment firm*; or
    - (i) that carries on *energy market activity* or *oil market activity*; and
  - (2) which carries out any of the following activities, in *investments* that are *financial instruments*:
    - (a) *arranging (bringing about) deals in investments*;
    - (b) *dealing in investments as agent*;
    - (c) *dealing in investments as principal*;
    - (d) *corporate finance business*;
    - (e) *managing investments*;
    - (f) *managing a UCITS* to the extent that this comprises the function of investment management referred to in Annex II of the *UCITS Directive*;
    - (g) *managing an AIF* to the extent that this comprises the function of portfolio management referred to in Annex I of *AIFMD*;
    - (h) *establishing, operating or winding up a collective investment scheme* to the extent that this comprises *scheme management activity*; and
    - (i) *energy market activity* and *oil market activity*,

only with respect to a *firm's* activities carried on from an establishment (including a *branch*) maintained by the *firm* in the *United Kingdom*.

[**Note:** article 16(7) and 16(11) of *MiFID*]

- 10A.1.2 G Where this chapter applies to a *third country investment firm*, it applies in conjunction with *GEN 2.2.22AR*, to ensure that such *firms* are not treated in a more favourable way than an *EEA firm*.
- 10A.1.3 R For a *firm* in *SYSC 10A.1.1R* (other than a *MiFID investment firm* or a *third country investment firm*) *MiFIR*, and any *EU Regulation* adopted under *MiFIR* or *MiFID*, apply to the extent relevant to the subject matter of this chapter as if it were a *MiFID investment firm* providing *investment services* or performing *investment activities* in accordance with article 16(7) of *MiFID*.
- 10A.1.4 R This chapter does not apply to the carrying on of:
- (1) activities between *operators* and *depositories*, of the same fund (when acting in that capacity); or
  - (2) *energy market activity* and *oil market activity* which is not *MiFID* or equivalent *third country business* but which, if the *firm* carrying it on were not *authorised*, would not be a *regulated activity* because of article 16 of the *Regulated Activities Order* (Dealing in contractually based investments) or article 22 of the *Regulated Activities Order* (Deals with or through authorised persons etc.),
- 10A.1.5 G *Firms* should refer to article 76 of the *MiFID Org Regulation*, which contains additional requirements on recording of telephone conversations or electronic communications, in addition to this chapter.

Obligations for telephone and electronic communications

- 10A.1.6 R A *firm* must take all reasonable steps to record telephone conversations, and keep a copy of electronic communications, that relate to the activities referred to in *SYSC 10A.1.1R*, and that are made with, sent from, or received on, equipment:
- (1) provided by the *firm* to an *employee* or contractor; or
  - (2) the use of which by an *employee* or contractor has been accepted or permitted by the *firm*.

[**Note:** article 16(7) of *MiFID*, third subparagraph]

- 10A.1.7 R A *firm* must take all reasonable steps to prevent an *employee* or contractor from making, sending, or receiving relevant telephone conversations and electronic communications on privately-owned equipment which the *firm* is unable to record or copy.

[Note: article 16(7) of *MiFID*, eighth subparagraph]

- 10A.1.8 R The telephone conversations and electronic communications referred to in *SYSC 10A.1.6R* include those that are intended to result in the performance of the activities referred to in *SYSC 10A.1.1R(2)*, even if those conversations or communications do not in fact result in the performance of such activities.

[Note: article 16(7) of *MiFID*, second subparagraph]

#### Notification

- 10A.1.9 R A *firm* must notify new and existing *clients* that telephone communications or conversations between the *firm* and its *clients* that result or may result in activities referred to in *SYSC 10A.1.1R(2)* will be recorded. The notification must be made before the provision of any *investment services* to new and existing *clients*.

[Note: article 16(7) of *MiFID*, fourth subparagraph]

- 10A.1.10 G A notification referred to in *SYSC 10A.1.9R* is only required to be made by the *firm* once, at the following times:
- (1) to a new *client* prior to the provision of any *investment services*; and
  - (2) to an existing *client* prior to the provision of any *investment services* following:
    - (a) the commencement of these *rules*; or
    - (b) the *firm* otherwise becoming subject to these *rules*, after the date of commencement.

[Note: article 16(7) of *MiFID*, fifth subparagraph]

#### Obligation for other communications

- 10A.1.11 R *Client* instructions given otherwise than by telephone must be made in a *durable medium* such as by mail, faxes, emails or documentation of *client* instructions issued at meetings. In particular, the content of relevant face-to-face conversations with a *client* may be recorded by using written minutes or notes.

[Note: article 16(7) of *MiFID*, seventh subparagraph]

#### Record-keeping

- 10A.1.12 R The records kept in accordance with this chapter must be:
- (1) provided by the *firm* to the *client* involved upon request; and
  - (2) kept for a period of five years and, where requested by the *FCA*, for a period of up to seven years.

[**Note:** article 16(7) of *MiFID*, ninth subparagraph]

Insert the following new row in SYSC Sch 1 (Record keeping requirements) in numerical order.

**Sch 1 Record keeping requirements**

...

Sch 1.2G

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
SYSC 10.1.6R	...	...	...	...
<u>SYSC 10A.1.6R</u>	<u>Telephone conversations and electronic communications in relation to stipulated activities in financial instruments (see SYSC 10A.1.1R)</u>	<u>Those activities in financial instruments</u>	<u>At the time of the conversation or communication</u>	<u>Five years from the date of the conversation or communication unless the FCA requests a period of seven years</u>
...	...	...	...	...

## Annex C

**Amendments to the Statements of Principle and Code of Practice for Approved Persons  
(APER)**

In this Annex, underlining indicates new text and striking through indicates deleted text.

**4 Code of Practice for Approved Persons: specific**

...

**4.7 Statement of Principle 7**

...

4.7.10 G In the case of an *approved person* performing an *accountable higher management function* responsible for compliance ~~under SYSC 3.2.8R, SYSC 6.1.4R or SYSC 6.1.4AR~~ in respect of the following provisions, failing to take reasonable steps to ensure that appropriate compliance systems and procedures are in place falls within *APER 4.7.2G*;

(1) SYSC 3.2.8R; or

(2) SYSC 6.1.4R; or

(3) article 22(3) of the *MiFID Org Regulation* (as applied in accordance with SYSC 1 Annex 1 2.8AR, SYSC 1 Annex 1 3.2-AAAR, SYSC 1 Annex 1 3.2-AAR, SYSC 1 Annex 1 3.2CR and SYSC 1 Annex 1 3.3R); or

(4) SYSC 6.1.4AR.

...

Annex D

Amendments to the Fit and Proper test for Approved Persons (FIT)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1 General

...

1.2 Introduction

...

1.2.1C G The key general *rules* relating to the criteria listed in *FIT* 1.2.1BG include:

...

(2) for *employees of firms* generally, ~~SYSC 5.1.1R~~ (the *competent employees rule*); and

...

...



## Annex E

## Amendments to the Training and Competence sourcebook (TC)

In this Annex, underlining indicates new text unless otherwise stated.

## 1 Application and Purpose

### 1.1 Who, what and where?

1.1.1 R ...

1.1.1A R The application of this sourcebook is modified for a *MiFID investment firm* and a *third country investment firm* by the provisions in TC 4.1 (subject to the limitations set out in TC App 2 and TC App 3).

1.1.1B G ESMA has issued guidelines for *MiFID investment firms* specifying the criteria for the assessment of knowledge and competence. The *ESMA guidelines* (published on 17 December 2015) can be found at <https://www.esma.europa.eu/press-news/esma-news/esma-publishes-translations-its-guidelines-assessment-knowledge-and-competence>.

...

Insert the following new chapter after TC 3 (Record keeping). All the text is new and is not underlined.

## 4 Specific modified requirements

### 4.1 Specified requirements for MiFID investment firms and for third country investment firms

4.1.1 R (1) The rules specified in TC 4.1.2R below are modified in relation to a *firm's MiFID or equivalent third country business* (subject to the limitations set out in TC App 2 and TC App 3) in respect of any *employee* ("relevant *employee*") who, on behalf of the *firm*, and to the extent that these activities also constitute activities within the scope of TC App 1:

- (i) makes *personal recommendations to retail clients* in relation to *financial instruments*; or
- (ii) provides information to *retail clients* about *financial instruments, investment services or ancillary services*.

4.1.2 R Unless the context requires otherwise the *rules* in this sourcebook are modified as follows:

Relevant rule	Modification adding the following requirements in addition to the relevant rule	
TC 2.1.1R(1)	(a)	The relevant <i>employee</i> must successfully demonstrate the ability to carry on the activities through previous work experience. This work must have been performed, on a full-time equivalent basis, for a minimum period of 6 <i>months</i> .
	(b)	The <i>firm</i> must take into account the nature of the relevant <i>employee's</i> role and level of responsibility within the <i>firm</i> and decide the appropriate level of knowledge and competence for that <i>employee</i> .
TC 2.1.1R(2)(c)	The relevant <i>employee</i> must have attained other tests or training courses that satisfy the criteria set out in the <i>ESMA</i> guidelines (see <i>TC 1.1.1BG</i> ) for the assessment of the knowledge and competence of the <i>employee</i> in that <i>EEA State</i> .	
TC 2.1.2R	The relevant <i>employee</i> , who is not assessed as competent, may not carry on those activities under supervision for a period exceeding 48 <i>months</i> .	
TC 2.1.5R(1)	Where an <i>employee</i> has not been assessed as competent to carry out the activities in relation to the <i>firm's MiFID or equivalent third country business</i> as described in <i>TC 4.1.1R</i> above:	
	(a)	the <i>firm</i> must ensure that the individual supervising the relevant <i>employee</i> :
		(i) has been assessed as competent to provide such <i>personal recommendation</i> or information;
		(ii) has the necessary skills and resources to act as a competent supervisor;
		(iii) takes responsibility for the <i>personal recommendation</i> or information, referred to in <i>TC 4.1.1R</i> above, provided by the relevant <i>employee</i> under supervision as if the supervisor is providing the <i>personal recommendation</i> including any <i>suitability report (COBS 9)</i> or information; and

	(b)	the <i>firm</i> must ensure that the supervision provided to an <i>employee</i> is tailored to the services provided by the <i>employee</i> .
--	-----	---

4.1.2 G Rules in this section relate to the requirements in SYSC 5.1.5AAR.

Amend the following text as shown. Underlining indicates new text.

**TP 1 Designated Investment Business: Assessments of competence before commencement**

1.1	R	(1)	...
		...	
<u>1.1A</u>	<u>G</u>	<u>Notwithstanding TC TP1 1.1R, a <i>firm</i> is subject to SYSC 5.1.5AAR in respect of such an <i>employee</i> and should have regard to the guidelines ESMA has issued for MiFID investment firms specifying the criteria for the assessment of knowledge and competence. The ESMA guidelines (published on 17 December 2015) can be found at <a href="https://www.esma.europa.eu/press-news/esma-news/esma-publishes-translations-its-guidelines-assessment-knowledge-and-competence">https://www.esma.europa.eu/press-news/esma-news/esma-publishes-translations-its-guidelines-assessment-knowledge-and-competence</a>.</u>	

## Annex F

## Amendments to the General Provisions (GEN)

In this Annex, underlining indicates new text.

**1 Appropriate regulator approval and emergencies**

...

**1.2 Referring to approval by the appropriate regulator**

...

1.2.2A R (1) Unless required to do so under the *regulatory system*, a *firm* must ensure that neither it nor anyone acting on its behalf claims, in a public statement or to a client, expressly or by implication, that its affairs, or any aspect of them, have the approval or endorsement of the *appropriate regulator* or another competent authority.

(1A) Paragraph (1) does not apply to a *firm* to the extent that it is incompatible with the *United Kingdom's* obligations under article 44(8) of the *MiFID Org Regulation*.

...

...

1.2.4 G A *firm that carries on MiFID, equivalent third country or optional exemption business* should have regard to the requirement in article 44(8) of the *MiFID Org Regulation* which is re-produced at COBS 4.5A.16EU.

...

## Annex G

**Amendments to the Interim Prudential sourcebook for Investment Businesses  
(IPRU(INV))**

In this Annex, underlining indicates new text and striking through indicates deleted text.

**3 Financial resources for Securities and Futures Firms which are not MiFID  
Investment Firms or which are Exempt BIPRU Commodities Firms or  
Exempt IFPRU Commodities Firms**

...

3-60 Firms to which Rules 3-61 to 3-182 apply

Broad scope firms

3-60(1) R Rules 3-61 to 3-182 apply to a *broad scope firm* except that rules 3-80 to 3-178 do not apply to a *venture capital firm* or in respect of *bidding in emissions auctions* carried on by a *firm* that is exempt from *MiFID* under article 2(1)~~(i)~~ (j)

...

Absolute minimum requirement – General rule

3-72 R A *firm's* absolute minimum requirement is:

...

(eb) for a *firm* that is exempt from *MiFID* under article 2(1)~~(i)~~ (j) and whose *permitted activities* include *bidding in emissions auctions*: £50,000;

...

...

[*Editor's note:* The text in this Annex takes into account the changes suggested by CP16/18 *Changes to disclosure rules in the FCA Handbook to reflect the direct application of PRIIPs Regulation* (July 2016), as if they were made.]

## Annex H

### Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

#### 1 Application

##### 1.1 ~~The general application rule~~ General application

~~[Note: ESMA has issued guidelines under article 16(3) of the ESMA Regulation on certain aspects of the MiFID suitability requirements which also includes guidelines on conduct of business obligations. See <http://www.esma.europa.eu/content/Guidelines-certain-aspects-MiFID-suitability-requirements>.]~~

Designated investment business and long-term insurance business in relation to life policies

##### 1.1.1 R ...

Deposits (including structured deposits)

1.1.1A R This sourcebook does not apply to a *firm* with respect to the activity of *accepting deposits* ~~carried on from an establishment maintained by it, or its appointed representative, in the United Kingdom,~~ except:

- (1) for *COBS* 4.6 (Past, simulated past and future performance), *COBS* 4.7.1R (Direct offer financial promotions), *COBS* 4.10 (Systems and controls and approving and communicating financial promotions), *COBS* 13 (Preparing product information) and *COBS* 14 (Providing product information to clients) which apply as set out in those provisions, *COBS* 4.1 and the Banking: Conduct of Business sourcebook (*BCOBS*); or
- (2) for the rules in this sourcebook which implement articles 24, 25, 26, 28 and 30 of *MiFID* (and related provisions of the *MiFID Delegated Directive*) which apply to a *MiFID investment firm*, a *third country investment firm* and a *MiFID optional exemption firm* when selling, or advising a client in relation to, structured deposits.

- 1.1.1AA **R** In the rules referred to in COBS 1.1.1AR(2) (and in any related guidance), references to:
- (1) investment services and designated investment business include selling, or advising clients in relation to, structured deposits; and
- (2) financial instruments and designated investments include structured deposits.
- 1.1.1AB **R** A third country investment firm and a MiFID optional exemption firm must also comply with the provisions of the MiFID Org Regulation which relate to the articles of MiFID referred to in COBS 1.1.1AR(2) when selling, or advising a client in relation to, structured deposits and such firms should have regard to article 1(2) of the MiFID Org Regulation in applying its provisions.
- 1.1.1AC **G** The provisions of MiFID and the MiFID Delegated Directive referred to in COBS 1.1.1AR(2) can be found in the chapters of COBS in the following table and are followed by a ‘Note:’.

<b><u>COBS chapter</u></b>	<b><u>Description</u></b>
<u>COBS 2</u>	<u>Conduct of business obligations</u>
<u>COBS 3</u>	<u>Client categorisation</u>
<u>COBS 4</u>	<u>Communicating with clients including financial promotions</u>
<u>COBS 6</u>	<u>Information about the firm, its services and remuneration</u>
<u>COBS 8A</u>	<u>Client agreements</u>
<u>COBS 9A</u>	<u>Suitability</u>
<u>COBS 10A</u>	<u>Appropriateness (for non-advised services)</u>
<u>COBS 11</u>	<u>Dealing and managing</u>
<u>COBS 14</u>	<u>Providing product information to clients</u>
<u>COBS 16</u>	<u>Reporting information to clients</u>

[Note: article 1(4) of MiFID]

Electronic money

1.1.1B R ...

Auction regulation bidding

1.1.1C R ...

Modifications to the general application ~~rule~~

1.1.2 R The ~~general application rule~~ application of this sourcebook is modified in COBS 1 Annex 1 according to the activities of a *firm* (Part 1) and its location (Part 2).

1.1.3 R The ~~general rule~~ application of this sourcebook is also modified in the chapters to this sourcebook for particular purposes, including those relating to the type of *firm*, its activities or location, and for purposes relating to connected activities.

...

After COBS 1.1 (The general application rule) insert the following new section. All the text is new and is not underlined.

## 1.2 Markets in Financial Instruments Directive

### References in COBS to the MiFID Org Regulation

- 1.2.1 G (1) This sourcebook contains a number of provisions which transpose *MiFID*.
- (2) In order to help *firms* which are subject to the requirements of *MiFID* to understand the full extent of those requirements, this sourcebook also reproduces a number of provisions of the directly applicable *MiFID Org Regulation*, marked with the status letters “EU”. The authentic provisions of the *MiFID Org Regulation* are directly applicable to firms in relation to their *MiFID business*.
- (3) This sourcebook does not reproduce the *MiFID Org Regulation* in its entirety. A *firm* to which provisions of the *MiFID Org Regulation* applies should refer to the electronic version of the Official Journal of the European Union for:



- (a) the authentic version of the applicable articles of the *MiFID Org Regulation*; and
  - (b) a comprehensive statement of its obligations under the *MiFID Org Regulation*.
- 1.2.2 G (1) In some cases, this sourcebook applies provisions of the *MiFID Org Regulation* to *firms* in relation to business other than their *MiFID business* as if those provisions were *rules*.
- (2) *Third country investment firms* should also have regard to the *rule* in *GEN 2.2.22AR* which concerns the application of the *MiFID Org Regulation* to such *firms*.
- 1.2.3 R (1) Where this sourcebook, or the rule in *GEN 2.2.22AR*, applies provisions of the *MiFID Org Regulation* as if they were *rules*, (2) applies to enable *firms* to correctly interpret and understand the application of those provisions.
- (2) In this sourcebook, a word or phrase found in a provision marked “EU” and referred to in column (1) of the table below has the meaning indicated in the corresponding row of column (2) of the table.

(1)	(2)
“ancillary services”	<i>ancillary service</i>
“client” and “potential client”	<i>Client</i>
“competent authority”	<i>FCA</i>
“conditions specified in Article 3(2)”	<i>website conditions</i>
“derivative”	as defined in article 4(1)(49) of <i>MiFID</i>
“Directive 2009/65/EC”	<i>UCITS Directive</i>
“Directive 2014/65/EU”	<i>MiFID</i>
“distributing units in collective investment undertakings”	distributing <i>units</i> in a <i>UCITS</i>
“durable medium”	<i>durable medium</i>

## Appendix 1

“eligible counterparty”	<i>eligible counterparty</i>
“financial analyst”	<i>financial analyst</i>
“financial instrument”	<i>financial instrument</i> and (if the context requires) <i>designated investment</i> and <i>structured deposit</i>
“funds”	<i>client money</i> that a <i>firm</i> receives or holds for, or on behalf of, a <i>client</i> in the course of, or in connection with, its <i>MiFID business</i> and (if the context requires) its <i>designated investment business</i> that is the <i>equivalent business of a third country investment firm</i> or <i>MiFID optional exemption business</i>
“group”	as defined in article 4(1)(34) of <i>MiFID</i>
“investments”	<i>financial instrument</i> and (if the context requires) <i>designated investment</i> and <i>structured deposit</i>
“investment advice”	<i>personal recommendation</i>
“investment firm” and “firm”	<i>Firm</i>
“investment research”	<i>investment research</i>
“investment service” and “investment services and activities”	<i>investment service</i> and <i>investment services and/or activities</i> or (if the context requires) <i>designated investment business</i>
“marketing communication”	<i>financial promotion</i>
“market maker”	<i>market maker</i>
“periodic statement”	<i>periodic statement</i> (see <i>COBS 16A.2.1EU</i> )

“PRIIPs KID”	<i>key information document</i>
“portfolio management” and “portfolio management service”	<i>portfolio management</i>
“professional client”	<i>professional client</i>
“professional client covered by Section 1 of Annex II to Directive 2014/65/EU”	<i>per se professional client</i>
“professional client in accordance with Section 2 of Annex II to Directive 2014/65/EU”	<i>elective professional client</i>
“Regulation (EU) No. 1286/2014”	<i>PRIIPs Regulation</i>
“relevant person”	<i>relevant person</i>
“retail client”	<i>retail client</i>
“shall”	Must
“tied agent”	<i>tied agent</i>
“UCITS KIID”	<i>key investor information document</i>

- (3) Any references within those provisions marked “EU” to other provisions of *EU* law must be interpreted in light of the purpose of this *rule*.
- (4) In this sourcebook, where a reproduced provision of an article of the *MiFID Org Regulation* includes a reference or cross-reference to another part of the *MiFID Org Regulation*, that reference or cross-reference must also be read with reference to the table in (2).

1.2.4 G *Firms* to which provisions of the *MiFID Org Regulation* are applied as if they were *rules* should use the text of any preamble to the relevant provision marked “EU” to assist in interpreting any such references or cross-references.

Interpretation – “in good time”

- 1.2.5 G (1) Certain of the provisions in this sourcebook which implement *MiFID* require *firms* to provide *clients* with information “in good time”.
- (2) In determining what constitutes the provision of information “in good time”, a *firm* should take into account, having regard to the urgency of the situation, the *client’s* need for sufficient time to read and understand the information before taking an investment decision.
- (3) A *client* is likely to require more time to review information given on a complex or unfamiliar product or service, or a product or service a *client* has no experience with, than a *client* considering a simpler or more familiar product or service, or where the *client* has relevant prior experience.

ESMA Guidelines

[**Note:** *ESMA* has issued a number of guidelines under article 16(3) of the *ESMA* Regulation in relation to certain aspects of *MiFID*. These include:

guidelines on certain aspects of the *MiFID* suitability requirements which also includes guidelines on conduct of business obligations. See [link];

guidelines on cross-selling practices. See [link]; and

guidelines on complex debt instruments and *structured deposits*. See [link].

Amend the following as shown.

**1 Annex 1 Application (see COBS 1.1.2R)**

Part 1: what?

Modifications to the general application rule according to activities

<b>1.</b>	<b>Eligible counterparty business</b>	
1.1	R	The <i>COBS</i> provisions shown below do not apply to <i>eligible counterparty business</i> .
	<b>COBS provision</b>	<b>Description</b>
	[ <i>To follow</i> ]	

		[ <del>Note: article 24(1)</del> paragraphs 1 and 2 of article 30(1) of <i>MiFID</i> ]
		...
<b>2.</b>	<b>Transactions between an MTF operator and its users</b>	
2.1	R	The <i>COBS</i> provisions in paragraph 1.1R and <i>COBS</i> 11.4 (Client limit orders) do not apply to a transaction between an operator of an <i>MTF</i> and a member or participant in relation to the use of the <i>MTF</i> .
		[ <del>Note: article 14(3)</del> 19(4) of <i>MiFID</i> ]
<b>3.</b>	<b>Transactions concluded on an MTF</b>	
3.1	R	The <i>COBS</i> provisions in paragraph 1.1R and <i>COBS</i> 11.4 ( <del>client</del> <u>Client</u> limit orders) do not apply to transactions concluded under the rules governing an <i>MTF</i> between members or participants of the <i>MTF</i> . However, the member or participant must comply with those provisions in respect of its <i>clients</i> if, acting on its <i>clients</i> behalf, it is executing their orders on an <i>MTF</i> .
		[ <del>Note: article 14(3)</del> 19(4) of <i>MiFID</i> ]
<b><u>3A.</u></b>	<b><u>Operators of OTFs</u></b>	
<u>3A.1</u>	<u>G</u>	<u>A firm which operates an organised trading facility should refer to MAR 5A.3.8R which specifies how the provisions in this sourcebook apply to that activity.</u>
<b>4.</b>	<b>Transactions concluded on a regulated market</b>	
4.1	R	In relation to transactions concluded on a <i>regulated market</i> , members and participants of the <i>regulated market</i> are not required to apply to each other the <i>COBS</i> provisions in paragraph 1.1R and <i>COBS</i> 11.4 (Client limit orders). However, the member or participant must comply with those provisions in respect of its <i>clients</i> if, acting on its <i>clients</i> behalf, it is executing their orders on a <i>regulated market</i> .
		[ <del>Note: article 42(4)</del> 53(4) of <i>MiFID</i> ]
<b>5.</b>	<b>Consumer credit products</b>	
5.1	R	If a <i>firm</i> , in relation to its <i>MiFID business</i> , offers an <i>investment service</i> as part of a financial product that is subject to other provisions of <i>EU</i> legislation or common European standards related to <i>credit institutions</i> and consumer credits with respect to <del>risk assessments of clients and/or</del> information requirements, that service is not subject to the <i>rules</i> in this

		sourcebook that implement <del>Article 19</del> <u>articles 24(3), (4) and (5) of MiFID.</u>	
		[ <del>Note: article 19(9)</del> <u>article 24(6) of MiFID</u> ]	
5.2	G	This exclusion for consumer credit products is intended to apply on a narrow basis in relation to cases in which the <i>investment service</i> is a part of another financial product. It does not apply where the <i>investment service</i> is the essential or leading part of the financial product. It also does not apply where the service provided is a combination of an <i>investment service</i> and an <i>ancillary service</i> (for example, granting a credit for the execution of an order where the credit is instrumental to the buying or the selling of a <i>financial instrument</i> .) The exclusion also does not apply in relation to the sale of a <i>financial instrument</i> for the purpose of enabling a <i>client</i> to invest money to repay his obligations under a loan, mortgage or home reversion.	
<b><u>5A.</u></b>	<b><u>Mortgages and mortgage bonds</u></b>		
<u>5A.1</u>	R	<u>The rule in paragraph 5A.2R applies in relation to an MCD credit agreement with a consumer which is subject to the provisions concerning the creditworthiness assessment of consumers in Chapter 6 of the MCD (as transposed in MCOB 11 and MCOB 11A).</u>	
<u>5A.2</u>	R	<u>If an agreement with a consumer within paragraph 5A.1R has as a pre-requisite the provision to that same consumer of an investment service in relation to mortgage bonds satisfying the conditions in paragraph 5A.3R in order for the loan to be payable, refinanced or redeemed, that investment service is not subject to the rules in this sourcebook which implement article 25 of MiFID.</u>	
<u>5A.3</u>	R	<u>The conditions in paragraph 5A.2R are that the mortgage bonds:</u>	
		(1)	<u>are specifically issued to secure the financing of the MCD credit agreement in paragraph 5A.1R; and</u>
		(2)	<u>have terms which are identical to the MCD credit agreement in paragraph 5A.1R.</u>
		[ <del>Note: article 25(7)</del> <u>of MiFID</u> ]	
...			

Part 2: Where?

Modifications to the general application rule according to location

...

## Part 3: Guidance

<b>1.</b>	<b>The main extensions, <u>modifications</u> and restrictions to the general application rule</b>		
1.1	G	The <del>general application rule</del> <u>general application of this sourcebook</u> is modified in Parts 1 and 2 of Annex 1 and in certain chapters of the <i>Handbook</i> . The modification may be an extension of <del>this rule</del> <u>the general application</u> . For example, <i>COBS 4</i> (Communicating with clients, including financial promotions) has extended the application of the rule.	
1.2	G	The provisions of the <i>Single Market Directives</i> and other directives also extensively modify the <del>general application rule</del> <u>general application of this sourcebook</u> , particularly in relation to territorial scope. <del>However, for the majority of circumstances, the general application rule is likely to apply.</del>	
<u>1.3</u>	<u>G</u>	<u>In particular, certain chapters of this sourcebook apply only to firms in relation to their <i>MiFID</i>, equivalent third country or <i>MiFID optional exemption business</i> while others apply only to firms' designated investment business which is not <i>MiFID</i>, equivalent third country or <i>MiFID optional exemption business</i>.</u>	
<u>1.4</u>	<u>G</u>	<u><i>COBS 18</i> (Specialist regimes) contains specialist regimes which modify the application of the provisions in this sourcebook for particular types of firm and business. To the extent that they are in conflict, the rules in <i>COBS 18</i> on the application of the provisions in this sourcebook should be understood as overriding any other provision (whether in <i>COBS 1</i> or an individual chapter) on the application of <i>COBS</i>. For the avoidance of doubt, nothing in <i>COBS 18</i> modifies the effect of the <i>EEA territorial scope rule</i>.</u>	
...			
<b>3.</b>	<b>MiFID: effect on territorial scope</b>		
3.1	G	<i>PERG 13</i> contains general guidance on the persons and businesses to which <i>MiFID</i> applies.	
3.2	G	This guidance concerns the rules within the scope of <i>MiFID</i> including those rules which are in the same subject area as the implementing rules. A rule is within the scope of <i>MiFID</i> if it is followed by a 'Note:' indicating the article of <i>MiFID</i> or the <del><i>MiFID implementing Directive</i></del> <i>MiFID Delegated Directive</i> which it implements.	
3.3	G	For a <i>UK MiFID investment firm</i> , rules in this sourcebook that are within the scope of <i>MiFID</i> generally apply to its <i>MiFID business</i> carried on from an	

		establishment in the <i>United Kingdom</i> . They also generally apply to its <i>MiFID business</i> carried on from an establishment in another <i>EEA State</i> , but only where that business is not carried on within the territory of that State. (See articles <del>31(1)</del> <u>34(1)</u> , and <del>32(1)</del> <u>35(1)</u> and <del>(7)</del> <u>35(8)</u> of <i>MiFID</i> )	
3.4	G	For an <i>EEA MiFID investment firm</i> , rules in this sourcebook that are within the scope of <i>MiFID</i> generally apply only to its <i>MiFID business</i> if that business is carried on from an establishment in, and within the territory of, the <i>United Kingdom</i> . (See article <del>32(1)</del> <u>35(1)</u> and <del>(7)</del> <u>35(8)</u> of <i>MiFID</i> )	
3.5	G	However, the rules on <i>investment research</i> and <i>non-independent research</i> ( <i>COBS</i> 12.2 and 12.3) and the rules on <i>personal transactions</i> ( <i>COBS</i> 11.7) apply on a "home state" basis. This means that they apply to the establishments of a <i>UK MiFID investment firm</i> in the <i>United Kingdom</i> and another <i>EEA State</i> and do not apply to an <i>EEA MiFID investment firm</i> .	
<u>3.6</u>	<u>G</u>	<u>Firms to which <i>MiFID</i> applies or which are subject to requirements in <i>MiFID</i> (including <i>MiFID optional exemption firms</i>) should also have regard to the rules and guidance in <i>COBS</i> 1.2.</u>	
...			
<b>9.</b>	<b>UCITS Directive: effect on territorial scope</b>		
9.1	G	The <i>UCITS Directive</i> covers undertakings for collective investment in transferable securities ( <i>UCITS</i> ) meeting the requirements of the Directive, and their <i>management companies</i> and <i>depositaries</i> . The rules in this sourcebook within the Directive's scope (all of which will apply to a <i>management company</i> ) are those in:	
		...	
		(6)	<del><i>COBS</i> 11.2</del> <u>11.2A</u> (Best execution);
		...	
...			
9.1D	G	<i>EEA UCITS management companies</i> should be aware that there is a special narrower application of <i>COBS</i> for <i>scheme management activity</i> provided for by <i>COBS</i> 18.5B ( <del>Residual CIS operators</del> , <i>UCITS management companies</i> and <i>AIFMs</i> ).	
...			
<b>10.</b>	<b>AIFMD: effect on territorial scope</b>		



...				
10.4	G	<p><i>Incoming EEA AIFM branches</i> should be aware that there is a special narrower application of <i>COBS</i> for <i>AIFM investment management functions</i> provided for by <i>COBS 18.5A</i> (<del>Residual CIS operators, UCITS management companies and AIFMs</del>).</p>		

## 2 Conduct of business obligations

### 2.1 Acting honestly, fairly and professionally

The client's best interests rule

- 2.1.1 R (1) A *firm* must act honestly, fairly and professionally in accordance with the best interests of its *client* (the *client's best interests rule*).
- (2) This *rule* applies in relation to *designated investment business* carried on:
- (a) for a *retail client*;
- (b) in relation to ~~*MiFID or equivalent third country business*~~ *MiFID, equivalent third country or optional exemption business*, for any other *client*.

...

[~~Note: article 19(1) 24(1) of MiFID~~] and article 14(1)(a) and (b) of the *UCITS Directive*]

#### Business with eligible counterparties

- 2.1.1A R In relation to its *eligible counterparty business*, a *firm* must act honestly, fairly and professionally, taking into account the nature of the *eligible counterparty* and its business.

[Note: article 30(1) of MiFID]

...

### 2.2 Information disclosure before providing services (non-MiFID provisions)

Application

- 2.2.-1 R (1) ~~This section applies in relation to *MiFID or equivalent third country business*. [deleted]~~
- (2) This section applies in relation to ~~other~~ *designated investment business other than MiFID, equivalent third country or optional*

exemption business, carried on for a *retail client*:

- (a) in relation to a *derivative*, a *warrant*, a *non-readily realisable security*, a *P2P agreement*, or *stock lending activity*, but as regards the matters in COBS 2.2.1R(1)(b) only; and
- (b) in relation to a *retail investment product*, but as regards the matters in COBS 2.2.1R(1)(a) and (d) only.

~~[Note: article 19(3) of MiFID]~~

2.2.-1A G COBS 2.2A (information disclosure before providing services (MiFID provisions)) contains the information disclosure requirements applying to a firm carrying on MiFID, equivalent third country or optional exemption business.

Information disclosure before providing services

2.2.1 R ...

~~[Note: article 19(3) of MiFID]~~

...

After COBS 2.2 (Information disclosure before providing services (non-MiFID provisions)) insert the following new section. All the text is new and is not underlined.

## 2.2A Information disclosure before providing services (MiFID provisions)

Application

2.2A.1 R This section applies to a *firm* in relation to its *MiFID, equivalent third country or optional exemption business*.

Information disclosure in good time

- 2.2A.2 R (1) A *firm* must provide appropriate information in good time to a *client* with regard to:
- (a) the *firm* and its services;
  - (b) the *financial instruments* and proposed investment strategies;
  - (c) execution venues; and
  - (d) all costs and related charges.
- (2) That information may be provided in a standardised format.

2.2A.3 R (1) A *firm* must provide the information required by this section in a comprehensible form in such a manner that a *client* is reasonably able to understand the nature and risks of the *investment service* and of the specific type of *financial instrument* that is being offered and, consequently, to take investment decisions on an informed basis.

(2) That information may be provided in a standardised format.

[Note: article 24(5) of *MiFID*]

#### Related rules

2.2A.4 G A *firm* to which the *rule* on providing appropriate information (*COBS* 2.2A.2R) applies should also consider the *rules* on disclosing information about a *firm*, its services, costs and associated charges and *financial instruments* in *COBS* 6.1-A and *COBS* 143A.

### 2.3 **Inducements relating to business other than MiFID, equivalent third country or optional exemption business**

...

#### Application

2.3.-1A R This section does not apply to:

(1) giving advice, or providing services, to an employer in connection with a *group personal pension scheme* or *group stakeholder pension scheme* where that scheme is a *qualifying scheme*; or

(2) a firm in relation to *MiFID*, equivalent third country or optional exemption business (but see *COBS* 2.3A (Inducements relating to *MiFID*, equivalent third country or optional exemption business)).

...

2.3.-1C G This section does not apply to the provision of *independent advice* or *restricted advice* on a *retail investment product* in the course of *MiFID*, *equivalent third country* or *optional exemption business*. A *firm* providing such a service should refer instead to *COBS* 2.3A (Inducements relating to *MiFID*, equivalent third country or optional exemption business) and *COBS* 6.1A (Adviser charging and remuneration).

#### Rule on inducements

2.3.1 R A *firm* must not pay or accept any fee or commission, or provide or receive any non-monetary benefit, in relation to *designated investment business* ~~or, in the case of its *MiFID* or *equivalent third country* business, another ancillary~~

~~service~~, carried on for a *client* other than:

...

- (2) a fee, commission or non-monetary benefit paid or provided to or by a third party or a *person* acting on behalf of a third party, if:

...

- (b) the existence, nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained, the method of calculating that amount, is clearly disclosed to the *client*, in a manner that is comprehensive, accurate and understandable, before the provision of the service;
- (i) this requirement only applies to business other than ~~*MiFID or equivalent third country business*~~ the carrying on by a UK UCITS management company or EEA UCITS management company of the collective portfolio management activities of investment management and administration for the relevant scheme if it includes:
- ...
- (ii) where this requirement applies to business other than ~~*MiFID or equivalent third country business*~~ the carrying on by a UK UCITS management company or EEA UCITS management company of the collective portfolio management activities of investment management and administration for the relevant scheme, a *firm* is not required to make a disclosure to the *client* in relation to a non-monetary benefit permitted under (a) and which falls within the table of reasonable non-monetary benefits in COBS 2.3.15G as though that table were part of this *rule* for this purpose only;
- (iii) ...
- (c) in relation to ~~*MiFID or equivalent third country business*~~ the carrying on by a UK UCITS management company or EEA UCITS management company of the collective portfolio management activities of investment management and administration for the relevant scheme or when carrying on a *regulated activity* in relation to a *retail investment product*, or when *advising on P2P agreements*, the payment of the fee or commission, or the provision of the non-monetary benefit is designed to enhance the quality of the service to the *client*; or

- (3) proper fees which enable or are necessary for the provision of *designated investment business* ~~or ancillary services~~, such as custody costs, settlement and exchange fees, regulatory levies or legal fees, and

which, by their nature, cannot give rise to conflicts with the *firm's* duties to act honestly, fairly and professionally in accordance with the best interests of its *clients*.

~~[Note: article 26 of the MiFID implementing Directive and articles 29(1) and 29(2) of the UCITS implementing Directive]~~

~~[Note: The European Securities and Markets Authority has issued recommendations on inducements under MiFID]~~

2.3.1A R *COBS 2.3.1R applies to a UK UCITS management company and EEA UCITS management company when providing collective portfolio management services, as if:*

~~(1) references to a *client*, were references to any UCITS it manages; and~~

~~(2) in (2)(b) and (c) and (3) of that rule, references to *MiFID or equivalent third-country business* were also references to the *collective portfolio management activities of investment management and administration for the scheme*.~~

~~[Note: article 29(1) of the UCITS implementing Directive]~~

2.3.2 R ...

~~[Note: article 26 of the MiFID implementing Directive and article 29(2) of the UCITS implementing Directive]~~

...

Guidance on inducements

...

2.3.4 G ~~*COBS 11.6 (Use of dealing commission) deals with the acceptance of certain inducements by investment managers and builds upon the requirements in this section. Investment managers should ensure they comply with this section and COBS 11.6. [deleted]*~~

2.3.4A G *A UCITS management company is subject to specific rules on inducements and research in COBS 18.5B when executing orders for financial instruments for, or on behalf of, the UCITS it manages (see [COBS 18.5B.6R] to [COBS 18 Annex 1]).*

...

2.3.6 G ~~*For the purposes of this section, the receipt by an investment firm of a commission in connection with a personal recommendation or a general recommendation, in circumstances where the advice or recommendation is not biased as a result of the receipt of commission, should be considered as designed to enhance the quality of the recommendation to the client. [deleted]*~~

~~[Note: recital 39 of MiFID implementing Directive]~~

...

2.3.7 G The fact that a fee, commission or non-monetary benefit is paid or provided to or by an *appointed representative* or, ~~where applicable, by a *tiered agent*~~, does not prevent the application of the *rule* on inducements.

2.3.8 G ~~The *rule* on inducements is applicable to a *firm* and those acting on behalf of a *firm* in relation to the provision of an *investment service* or *ancillary service* to a *client*. Small gifts and minor hospitality received by an individual in their personal capacity below a level specified in the *firm's* conflict's of interest policy, will not be relevant for the purpose of the *rule* on inducements.~~  
[deleted]

...

Reasonable non-monetary benefits

...

2.3.16A G ...

Application of guidance on reasonable non-monetary benefits

2.3.16B R The guidance on reasonable non-monetary benefits in COBS 2.3.14G to COBS 2.3.16AG does not apply to a *firm* which:

- (1) makes *personal recommendations to retail clients* in relation to *retail investment products* or *P2P agreements*, and to which *COBS 6.1A (Adviser charging and remuneration)* applies; or
- (2) is a *retail investment product provider*, a *platform service provider* or a *firm* which is an *operator of an electronic system in relation to lending to which COBS 6.1B (Retail investment product provider, operator of an electronic system relating to lending, and platform service provider requirements relating to adviser charging and remuneration)* applies.

2.3.16C G However, *COBS 6.1A* and *COBS 6.1B* do permit minor non-monetary benefits which meet the relevant requirements set out in [*COBS 6.1A.5AR*].

...

Record keeping: inducements

2.3.17 R ...

~~[Note: see article 51(3) of the MiFID implementing Directive]~~

Insert the new COBS 2.3A after 2.3 (Inducements relating to business other than MiFID or equivalent third country business). The text is new and is not underlined.

**2.3A Inducements relating to MiFID, equivalent third country or optional exemption business**

Application

- 2.3A.1 R This section applies to a *firm* in relation to its *MiFID, equivalent third country or optional exemption business*.
- 2.3A.2 G (1) A *firm* which makes a *personal recommendation* to a *retail client* in the *United Kingdom* in relation to a *retail investment product* in the course of carrying on *MiFID, equivalent third country or optional exemption business* with or for that *client* should also refer to *COBS 6.1A* (Adviser charging and remuneration) which provides that a *firm* must only be remunerated for the *personal recommendation* (and any other related services provided by the *firm*) by *adviser charges*.
- (2) This section also applies to a *firm* which is a *retail investment product* provider or a *platform service provider* and which carries on *MiFID, equivalent third country or optional exemption business* in relation to those activities. The *firm* should also refer to *COBS 6.1B* (Retail investment product provider, operator of an electronic system relating to lending, and platform service provider requirements relating to adviser charging and remuneration) and *COBS 6.1E* (Platform services: platform charges using a platform service for advising).

Rules on inducements relating to the provision of investment services and ancillary services

- 2.3A.3 R (1) A *firm* must not pay or accept any fee or commission, or provide or receive any non-monetary benefit in connection with the provision of an *investment service* or an *ancillary service* other than:
- (a) a fee, commission or non-monetary benefit paid or provided to or by the *client* or a *person* on behalf of the *client*; or
- (b) a fee, commission or non-monetary benefit which:
- (i) is designed to enhance the quality of the relevant service to the *client* (see [*COBS 2.3A.4R*]); and
- (ii) does not impair compliance with the *firm*'s duty to act honestly, fairly and professionally in the best interests of the *client*; or
- (c) a payment or benefit which enables or is necessary for the provision of an *investment service* by the *firm*, such as custody costs, settlement and exchange fees, regulatory levies or legal

fees and which, by its nature, cannot give rise to conflicts with the *firm's* duty to act honestly, fairly and professionally in the best interests of the *client*.

- (2) Where a *firm* pays, provides, accepts or receives, a fee, commission or non-monetary benefit which falls within [sub-paragraph (1)(b)], the *firm* must clearly disclose to the *client*:
  - (a) the existence and nature of the payment or benefit; and
  - (b) the amount of the payment or benefit or, where the amount cannot be ascertained, the method for calculating that amount.
- (3) That information must be disclosed:
  - (a) prior to the provision of the relevant service; and
  - (b) in a manner that is comprehensive, accurate and understandable (see also [COBS 2.3A.6R (Disclosure of payments or benefits received from, or paid to, third parties)]).
- (4) Where applicable, a *firm* must inform a *client* of the mechanisms for transferring to the *client* the fee, commission, monetary or non-monetary benefit received in relation to the provision of the relevant service.

[Note: article 24(9) of MiFID]

Fees, commissions or non-monetary benefits which are designed to enhance the quality of a service

- 2.3A.4 R (1) For the purposes of [COBS 2.3A.3R(1)(b)(i)], a fee, commission or non-monetary benefit is designed to enhance the quality of the relevant service to a *client* only if :
- (a) it is justified by the provision of an additional or higher level service to the *client* and is proportional to the level of inducements received;
  - (b) it does not directly benefit the recipient *firm*, its *shareholders* or *employees* without tangible benefit to the *client*;
  - (c) it is justified by the provision of an ongoing benefit to the *client* in relation to an ongoing inducement; and
  - (d) the provision of the service by the *firm* to the *client* is not biased or distorted as a result of the fee, commission or non-monetary benefit.



- (2) A *firm* must fulfil these conditions on an ongoing basis as long as the *firm* continues to pay or receive the fee, commission or non-monetary benefit.

[**Note:** article 11(2) and (3) of the *MiFID Delegated Directive*]

2.3A.5 R A fee, commission or non-monetary benefit may be justified for the purposes of [*COBS* 2.3A.4R(1)(a)] where, for example, the *firm* provides:

- (1) *restricted advice* on, and access to, a wide range of suitable *financial instruments* including an appropriate number of *financial instruments* from third party product providers having no close links with the *firm*;  
or
- (2) *restricted advice* combined with:
- (a) 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
- (b) another ongoing service that is likely to be of value to the *client* such as advice about the suggested optimal asset allocation of the *client*; or
- (3) 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 *financial instruments* from third party product providers having no close links with the *firm*, together with either the provision of added-value tools, such as objective information tools helping the *client* to take investment decisions or enabling the *client* to monitor, model and adjust the range of *financial instruments* in which they have invested, or providing periodic reports of the performance and costs and charges associated with the *financial instruments*.

[**Note:** article 11(2) of the *MiFID Delegated Directive*]

[**Note:** further guidance on this is contained in the *FCA*'s Finalised Guidance on 'Supervising retail investment advice: inducements and conflicts of interest' (FG 14/1), available at:  
<https://www.fca.org.uk/publication/finalised-guidance/fg14-01.pdf>]

Disclosure of payments or benefits received from, or paid to, third parties

- 2.3A.6 R (1) Prior to the provision of the relevant service, the *firm* must disclose to the *client* the information set out in [*COBS* 2.3A.3R(2)] and, where applicable, [*COBS* 2.3A.3R(4)].
- (2) For these purposes, minor non-monetary benefits may be described in a generic way, but other non-monetary benefits received or paid by the *firm* in connection with a service provided to the *client* must be priced and disclosed separately.

[**Note:** article 11(5)(a) of the *MiFID Delegated Directive*]

- 2.3A.7 R Where a *firm* is unable to ascertain on an ex-ante basis the amount of any payment or benefit to be received or paid, and instead discloses to the *client* the method of calculating the relevant amount, the *firm* must also inform the *client* of the exact amount of the payment or benefit received or paid on an ex-post basis.

[**Note:** article 11(5)(b) of the *MiFID Delegated Directive*]

- 2.3A.8 R (1) Where inducements are received by the *firm* on an ongoing basis in relation to an *investment service* provided to a *client*, the *firm* must inform, at least annually, that *client* about the actual amount of payments or benefits received.
- (2) For these purposes, minor non-monetary benefits may be described in a generic way.

[**Note:** article 11(5)(c) of the *MiFID Delegated Directive*]

- 2.3A.9 R In implementing the requirements of [COBS 2.3A.6R] to [COBS 2.3A.8R], a *firm* must take into account the costs and charges rules set out in article 24(4)(c) of *MiFID* and [article 50] of the *MiFID Org Regulation* (see COBS [6.1-A.2.7R] to [6.1-A.2.9R] and 6.1-A.2.10EU).

[**Note:** article 11(5) of the *MiFID Delegated Directive*]

- 2.3A.10 R Each *firm* involved in a distribution channel which provides an *investment service* or *ancillary service* must comply with its obligations to make disclosures to its *clients*.

[**Note:** article 11(5) of the *MiFID Delegated Directive*]

Inducements relating to the provision of independent advice, restricted advice and portfolio management services to retail clients

- 2.3A.11 R (1) This *rule* applies where a *firm* provides a *retail client* with:
- (a) *independent advice*; or
  - (b) *restricted advice*; or
  - (c) *portfolio management services*.
- (2) The *firm* must not accept any fees, commission, monetary or non-monetary benefits which are paid or provided by:
- (a) any third party; or
  - (b) a *person* acting on behalf of a third party,
- in relation to the provision of the relevant service to the *client*.

- (3) Paragraph (2) does not apply to acceptable minor non-monetary benefits (see [COBS 2.3A.15R]).

[**Note:** see articles 24(7)(b) and 24(8) of *MiFID*; article 12(2) of the *MiFID Delegated Directive*]

Inducements relating to the provision of independent advice and portfolio management services to professional clients

- 2.3A.12 R (1) This *rule* applies where a *firm* provides a *professional client* with:
- (a) *independent advice*; or
  - (c) *portfolio management services*.
- (2) In relation to the provision of the relevant service to the *client*, the *firm* must not:
- (a) accept and retain any fees, commission or monetary benefits; or
  - (b) accept any non-monetary benefits other than acceptable minor non-monetary benefits (see [COBS 2.3A.15R]),
- where these are paid or provided by any third party or a *person* acting on behalf of a third party.
- (3) With regard to paragraph (2), the *firm* must:
- (a) return to the *client* as soon as reasonably possible after receipt any fees, commission 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*;
  - (b) transfer in full to the *client* all fees, commission or monetary benefits received from third parties in relation to the services provided to the *client*;
  - (c) establish and implement a policy to ensure that any fees, commission 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 the services to the *client* are allocated and transferred to that *client*; and
  - (d) inform the *client* about the fees, commission or any monetary benefits transferred to them, such as through the periodic reporting statements provided to the *client*.

[**Note:** articles 24(7)(b) and 24(8) of *MiFID*; article 12(1) and (2) of the *MiFID Delegated Directive*]

- 2.3A.13 G SYSC 4.1 (General requirements) sets out further organisational requirements

relating to *firms*.

Fees, commission, and non-monetary benefits paid or provided by a person on behalf of the client

2.3A.14 G Fees, commission or non-monetary benefits paid or provided by a *person* on behalf of the *client* are acceptable only if that *person* is aware that such payments have been made on that *client's* behalf and the amount and frequency of any payment is agreed between the *client* and the *firm* and not determined by a third party. This could be the case where:

- (1) a *client* pays a *firm's* invoice directly or it is paid by an independent third party who has no connection with the *firm* regarding the *investment service* provided to the *client* and is acting only on the instructions of the *client*; or
- (2) cases where the *client* negotiates a fee for a service provided by a *firm* and pays that fee.

This would generally be the case for accountants or lawyers acting under a clear payment instruction from the *client* or where a *person* is acting as a mere conduit for the payment.

[**Note:** recital 75 to *MiFID*]

Acceptable minor non-monetary benefits

2.3A.15 R An acceptable minor non-monetary benefit is one which is:

- (1) clearly disclosed prior to the provision of the relevant service to the *client*, which the *firm* may describe in a generic way (where applicable, in accordance with [article 50(5)(a)] of the *MiFID Org Regulation*);
- (2) capable of enhancing the quality of service provided to the *client*;
- (3) of a scale and nature that it could not be judged to impair the *firm's* compliance with its duty to act honestly, fairly and professionally in the best interests of the *client*;
- (4) reasonable, proportionate and of a scale that is unlikely to influence the *firm's* behaviour in any way that is detrimental to the interests of the relevant *client*; and
- (5) which consists of:
  - (a) information or documentation relating to a *financial instrument* or an *investment service*, that 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 a corporate *issuer* or potential *issuer* to promote a new issuance by the company, or where the third party *firm* is

contractually engaged and paid by the *issuer* to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any *firms* wishing to receive it, or to the general public;

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

[**Note:** articles 24(7)(b) and 24(8) of *MiFID*; article 12(2) and (3) of the *MiFID Delegated Directive*]

- 2.3A.16 G [COBS 2.3A.4R] sets out the conditions to be met if a fee, commission or non-monetary benefit is designed to enhance the quality of the service to a *client*. Those conditions are also likely to be relevant to *firms* considering whether a fee, commission or non-monetary benefit is capable of enhancing the quality of the service to a *client*.

[**Note:** articles 24(7) and (8) of *MiFID* refer to minor non-monetary benefits that are capable of enhancing the quality of service provided to the *client*]

- 2.3A.17 G A non-monetary benefit that involves a third party allocating valuable resources to the *firm* is not a minor non-monetary benefit and accordingly is considered to impair compliance with the *firm's* duty to act in the *client's* best interest.

[**Note:** recital 30 to the *MiFID Delegated Directive*]

- 2.3A.18 G For the purposes of [COBS 2.3A.15R(4) and (5)(a)], non-substantive material or services consisting of short term market commentary on the latest economic statistics or company results or information on upcoming releases or events which are provided by a third party and which:

- (1) contain only a brief unsubstantiated summary of the third party's own opinion on the information; and
- (2) do not include any substantive analysis (e.g. where the third party simply reiterates a view based on an existing recommendation or substantive research),

can be deemed to be information relating to a *financial instrument* or *investment service* of a scale and nature such that it constitutes an acceptable minor non-monetary benefit.

[**Note:** recital 29 to the *MiFID Delegated Directive*]

## Paying commission on non-advised sales of packaged products

- 2.3A.19 G The following *guidance* and *evidential provisions* provide examples of arrangements the *FCA* believes will breach the *client's best interests rule* if a *firm* sells or *arranges* the sale of a *packaged product* for a *retail client*.
- 2.3A.20 E (1) If a *firm* is required to disclose commission (see *COBS* 6.4 (Disclosure of charges, remuneration and commission)) to a *client* in relation to the sale of a *packaged product* (other than in relation to arrangements between *firms* that are in the same *immediate group*) the firm should not enter into any of the following:
- (a) volume overrides, if commission paid in respect of several transactions is more than a simple multiple of the commission payable in respect of one transaction of the same kind; and
  - (b) an agreement to indemnify the payment of commission on terms that would or might confer an additional financial benefit on the recipient in the event of the commission becoming repayable.
- (2) Contravention of (1) may be relied upon as tending to establish contravention of [*COBS* 2.3A.3R].
- 2.3A.21 G If a *firm* enters into an arrangement with another *firm* under which it makes or receives a payment of commission in relation to the sale of a *packaged product* that is increased in excess of the amount disclosed to the *client*, the *firm* is likely to have breached the *rules* on disclosure of charges, remuneration and commission (see *COBS* 6.4) and, where applicable, the *rules* on inducements in [*COBS* 2.3A.3R(2) and (3)], unless the increase is attributable to an increase in the *premiums* or contributions payable by that *client*.

## Providing credit and other benefits to firms that advise retail clients on retail investment products

- 2.3A.22 G The following *guidance* and *evidential provisions* provide examples of arrangements the *FCA* believes will breach the *client's best interests rule* in relation to a *personal recommendation* of a *retail investment product* to a *retail client*.
- 2.3A.23 E (1) This *evidential provision* applies in relation to a holding in, or the provision of *credit* to, a *firm* which holds itself out as making *personal recommendations* to *retail clients* on *retail investment products*, except where the relevant transaction is between *persons* who are in the same *immediate group*.
- (2) A *retail investment product* provider should not take any step which would result in it:
- (a) having a direct or indirect holding of the capital or *voting power*

of a *firm* in (1); or

- (b) providing *credit* to a *firm* in (1) (other than continuing to facilitate the payment of an *adviser charge* or *consultancy charge* where it is no longer payable by the *retail client*, as described in *COBS 6.1A.5G* or *COBS 6.1C.6G*);

unless all the conditions in (4) are satisfied. A *retail investment product* provider should also take reasonable steps to ensure that its *associates* do not take any step which would result in it having a holding as in (a) or providing *credit* as in (b).

- (3) A *firm* in (1) should not take any step which would result in a *retail investment product* provider having a holding as in (2)(a) or providing *credit* as in (2)(b), unless all the conditions in (4) are satisfied.
- (4) The conditions referred to in (2) and (3) are that:
  - (a) the holding is acquired, or *credit* is provided, on commercial terms, that is terms objectively comparable to those on which an independent *person* unconnected to a *retail investment product* provider would, taking into account all relevant circumstances, be willing to acquire the holding or provide *credit*;
  - (b) the *firm* (or, if applicable, each of the *firms*) taking the step has reliable written evidence that (a) is satisfied;
  - (c) there are no arrangements, in connection with the holding or *credit*, relating to the channelling of business from the *firm* in (1) to the *retail investment product* provider; and
  - (d) the *retail investment product* provider is not able, and none of its *associates* is able, because of the holding or *credit*, to exercise any influence over the *personal recommendations* made in relation to *retail investment products* given by the *firm*.
- (5) In this *evidential provision*, in applying (2) and (3) any holding of, or *credit* provided by, a *retail investment product* provider's *associate* is to be regarded as held by, or provided by, that *retail investment product* provider.
- (6) Contravention of (2) or (3) may be relied upon as tending to establish contravention of the [*COBS 2.3A.11R*].

2.3A.24 G Where a *retail investment product* provider, or its *associate*, provides *credit* to a *retail client* of a *firm* making *personal recommendations* in relation to *retail investment products*, this may create an indirect benefit for the *firm* and, to the extent that this is relevant, the provider of *retail investment products* may need to consider the examples in [*COBS 2.3A.23E*] as if it had provided the *credit* to the *firm*.

- 2.3A.25 G In considering the compliance of arrangements between members of the same *immediate group* with [COBS 2.3A.11R], *firms* may wish to consider the *evidential provisions* in [COBS 2.3A.20E] and [COBS 2.3A.23E], to the extent that these are relevant.

Guidance on inducements

- 2.3A.26 G A *firm* which fails to comply with the rules on inducements will not meet its obligations in relation to conflicts of interest (see SYSC 10) or the obligation to act honestly, professionally and fairly in accordance with the best interests of its *clients*.

[Note: article 24(9) of MiFID]

- 2.3A.27 G A *firm* is unlikely to meet its obligations relating to best execution (see [COBS 11.2A]), inducements (in this section), and conflicts of interest (see SYSC 10) where it receives payment, remuneration or commission from third parties (including those entities to whom or which it directs orders for execution) in relation to the execution of *client* orders. *Firms* should also have regard to the FSA's Guidance on the practice of 'Payment for Order Flow'.

[Note: for the FSA's Guidance on the practice of 'Payment for Order Flow' see: <http://www.fca.org.uk/publication/finalised-guidance/fg12-13.pdf>]

Record keeping: inducements

- 2.3A.28 R A *firm* must hold evidence that any fees, commission or non-monetary benefits paid or received by the *firm* are designed to enhance the quality of the relevant service to the *client* by:
- (1) keeping an internal list of all fees, commission and non-monetary benefits received by the *firm* from a third party in relation to the provision of the service; and
  - (2) recording how the fees, commission and non-monetary benefits paid or received by the *firm*, or that the *firm* intends to use, enhance the quality of the services provided to the relevant *clients* and the steps taken in order not to impair the *firm's* compliance with the duty to act honestly, fairly and professionally in the best interests of the *client*.

[Note: article 11(4) of the MiFID Delegated Directive]

- 2.3A.29 G In relation to the *MiFID business* of a *firm*, article 72 and Annex 1 of the *MiFID Org Regulation* also make provision for the keeping of records on inducements.

[Note: article 72 and Annex 1 of the *MiFID Org Regulation*]

- 2.3A.30 R In relation to the *equivalent business of a third country investment firm* and *MiFID optional exemption business*, information disclosed to the *client* in



accordance with [COBS 2.3A.3R(2), (3) and (4) and COBS 2.3A.6R to COBS 2.3A.8R] shall be retained in a medium that allows the storage of information in a way accessible for future reference by the FCA, and in such a form and manner that:

- (1) the FCA is able to access it readily and to reconstitute each key stage of the processing of each transaction;
- (2) it is possible for any corrections or other amendments, and the contents of the records prior to such corrections or amendments, to be easily ascertained;
- (3) it is not possible for the records otherwise to be manipulated or altered;
- (4) it can be exploited through information technology or any other efficient method of exploitation when analysis of the data cannot be easily carried out due to the volume and nature of the data; and
- (5) the firm's arrangements comply with the record keeping requirements irrespective of the technology used.

## 2.3B Inducements and research

Application

2.3B.1 R This section applies to a firm carrying on *MiFID*, *equivalent third country* or *optional exemption business*.

2.3B.2 G (1) Firms providing *restricted advice to retail clients*, *independent advice* or *portfolio management* are prohibited from receiving inducements (other than acceptable minor non-monetary benefits) in relation to those services under COBS 2.3A.11R(2) and COBS 2.3A.12R(2). Compliance with COBS 2.3B allows such firms to receive third party *research* without breaching that prohibition.

(2) In addition, COBS 2.3B enables *investment firms* providing services other than *restricted advice to retail clients*, *investment advice* or *portfolio management* to receive *research* without subjecting it to an assessment under the inducements rule in COBS 2.3A as *research* acquired in accordance with this section will not constitute an inducement.

Receiving third party research without it constituting an inducement

2.3B.3 R Third party *research* that is received by a firm providing *investment services* or *ancillary services* to *clients* will not be an inducement under COBS 2.3A.3R(1), COBS 2.3A.11R(2) or COBS 2.3A.12R(2) if it is received in return for either of the following:

- (1) direct payments by the firm out of its own resources; or

- (2) payments from a separate *research* payment account controlled by the *firm*, provided that the *firm* meets the requirements in *COBS* 2.3B.4 relating to the operation of the account.

[**Note:** article 13(1)(a) and (b)(excl. (i) – (iv)) of the *MiFID Delegated Directive*]

Conditions relating to the operation of the research payment account

- 2.3B.4 R The requirements referred to in *COBS* 2.3B.3(2) for the operation of a *research* payment account are:
- (1) the *research* payment account must only be funded by a specific *research* charge to *clients*, which must:
- (a) only be based on a *research* budget set by the *firm* 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 or value of transactions executed on behalf of *clients*;
- (2) (a) the *firm* must set and regularly assess a *research* budget as an internal administrative measure as part of establishing a *research* payment account and agreeing the *research charge* with its *clients*;
- (b) the *research* budget must comply with *COBS* 2.3B.7R, *COBS* 2.3B.8R(2) and *COBS* 2.3B.11R;
- (3) the *firm* must be fully responsible for the *research* payment account; and
- (4) the *firm* must regularly assess the quality of the *research* purchased, based on robust quality criteria, and its ability to contribute to better investment decisions for the *clients* who pay the *research* charge.

[**Note:** article 13(1)(b)(i-iv) and (2)(a) and (b) of the *MiFID Delegated Directive*]

- 2.3B.5 R A *firm* using a *research* payment account must provide the following information to *clients*:
- (a) before the provision of an *investment service* or *ancillary service* to *clients*, information about the budgeted amount for *research* and the amount of the estimated *research* charge for each of them; and
- (b) annual information on the total costs that each of them has incurred for third party *research*.

[**Note:** article 13(1)(c) of the *MiFID Delegated Directive*]

- 2.3B.6 G A *firm* should inform *clients* in the annual information in COBS 2.3B.5(b) that they are entitled to request the information set out in COBS 2.3B.20R(1).
- 2.3B.7 R A *firm* must ensure that:
- (1) the total amount of *research* charges collected from *clients* under COBS 2.3B.4R(1) does not exceed the *research* budget established under COBS 2.3B.4R(2) (and, where relevant, amended under COBS 2.3B.8(2)); and
  - (2) the *research* budget and *research* payment account are not used to fund research generated internally by the *firm* itself.
- [Note: article 13(4) and (6) of the *MiFID Delegated Directive*]
- 2.3B.8 R (1) A *firm* must agree with *clients*, in the *firm's* investment management agreement or general terms of business:
- (a) the *research* charge as budgeted by the *firm*; and
  - (b) the frequency with which the specific *research* charge will be deducted from the resources of the *client* over the year.
- (2) A *firm* must not increase its *research* budget unless it has provided, in advance, clear information to relevant *clients* about such intended increases.
- (3) If there is a surplus in a *research* payment account at the end of a period, the *firm* must have a process to:
- (a) rebate those funds to relevant *clients*; or
  - (b) offset it against the *research* budget and charge for relevant *clients* calculated for the following period.
- [Note: article 13(5) of the *MiFID Delegated Directive*]
- (4) In calculating a rebate or offset as set out in (3), *firms* must take reasonable steps to maintain a fair allocation of costs between *clients*.
- 2.3B.9 G Information on increases on the *research* budget under COBS 2.3B.8R(2) should be provided to relevant *clients* in good time before such increases are to take effect.
- 2.3B.10 G *Firms* that operate arrangements for collecting *research* charges by deducting charges from those *clients'* resources should ensure that those arrangements comply with CASS 8 (Mandates), as applicable.

Governance and oversight of research payment accounts

- 2.3B.11 R For the purposes of *COBS* 2.3B.4R(2), a *firm* must ensure that:
- (1) the *research* budget is managed solely by the *firm* and is based on a reasonable assessment of the need for third party *research*;
  - (2) the allocation of the *research* budget to purchase third party *research* is subject to appropriate controls and *senior management* oversight to ensure it is managed and used in the best interests of the *firm*'s *clients*; and
  - (3) the controls under (2) include a clear audit trail of:
    - (a) payments made to *research* providers; and
    - (b) how the amounts paid were determined with reference to:
      - (i) the quality criteria required by *COBS* 2.3B.4R(4); and
      - (ii) the *firm*'s policy for using third party *research* established under *COBS* 2.3B.12R.

[**Note:** article 13(6) of the *MiFID Delegated Directive*]

- 2.3B.12 R (1) *Firms* using a *research* payment account must establish a written policy that sets out how the *firm* will:
- (a) comply with all elements of *COBS* 2.3B.4R(4); and
  - (b) 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 *firm* will take to allocate such costs fairly to the various *clients*' portfolios.
- (2) *Firms* must provide the policy established under (1) to their *clients*.

[**Note:** article 13(8) of the *MiFID Delegated Directive*]

- 2.3B.13 G *Firms* should retain control over the overall spending for *research*, the collection of *client research* charges and the determination of payments.

[**Note:** recital (28) to the *MiFID Delegated Directive*]

- 2.3B.14 G In setting a budget under *COBS* 2.3B.4(2), and in light of the obligation to fairly allocate costs under *COBS* 2.3B.12R(1)(b), a *firm* may wish to consider setting a budget for a group of *clients* who would benefit from the same *research*, for example because they have portfolios that are managed according to similar investment strategies. It may be appropriate to operate a dedicated *research* payment account for such a group.

- 2.3B.15 G Where a *firm* charges a *client* under COBS 2.3B.4R(1), that charge should be for an amount of *money* owed to the *firm*. Therefore, provided it is collected by the *firm* only when that charge becomes due and payable, that *money* will not be *client money* held by the *firm* for the *client* who owed that charge (see CASS 7.11.25R).

Other operational arrangements for research payment accounts

- 2.3B.16 R If a *firm* uses an operational arrangement for the collection of the charge under COBS 2.3B.4R(1) where that charge is not collected separately but alongside a transaction *commission*, the *firm* must still indicate a separately identifiable *research* charge and ensure that the arrangements comply fully with the conditions in COBS 2.3B.4R and COBS 2.3B.5R.

[Note: article 13(3) of the *MiFID Delegated Directive*]

- 2.3B.17 G A *firm* should ensure that the cost of *research* funded by *client* charges is not:

- (1) linked to the volume or value of services or benefits that are not *research*; or
- (2) used to cover anything other than *research*, such as charges for execution.

[Note: recital 27 to the *MiFID Delegated Directive*]

- 2.3B.18 R For the purposes of COBS 2.3B.3R and COBS 2.3B.4R, a *firm* may delegate the administration of the *research* payment account to a third party, provided that the arrangement facilitates payments to *research* providers, in the name of the *firm*, for the purchase of third party *research*, without any undue delay and in accordance with the *firm*'s instruction.

[Note: article 13(7) of the *MiFID Delegated Directive*]

- 2.3B.19 G (1) In order that a *firm* retains sufficient control, and is responsible for, a *research* payment account when relying on a third party to administer it, the *firm* should consider whether its arrangements with that third party will ensure that:

- (a) the *firm* can collect *client research* charges relating to a specific *research* budget into a separate *research* payment account for that budget, as cleared funds, without undue delay;
- (b) the *firm* retains sole, full and absolute discretion over the use of the account and the making of payments or rebates;
- (c) *research* payment account monies are ring-fenced and separately identifiable from the assets of the third party or, where the third party administrator is a *bank*, are held on

deposit for the *firm*; and

- (d) the third party provider has, or its creditors on insolvency have, no right of access or recourse to the *research* payment account for its own benefit, for example to offset other fees owed by the *firm* or for use as collateral.

- (2) The *firm* remains fully responsible for discharging all of its obligations to its *clients* set out in *COBS* 2.3B regardless of any arrangements they make with third parties, and should ensure it acts in the best interests of its *clients* when deducting *research* charges from their accounts and procuring *research*.

Disclosure on request of payments made from a research payment account

- 2.3B.20 R (1) Where a *firm* operates a *research* payment account, it must provide on request to its *clients* a summary of:
- (a) the providers paid from this account;
  - (b) the total amount they were paid over a defined period;
  - (c) the benefits and services received by the *firm*; and
  - (d) how the total amount spent from the account compares to the budget set by the *firm* for that period, noting any rebate or carry-over if residual funds remain in the account.
- (2) A *firm* must also be able to provide the information in paragraph (1) to the *FCA* on request for all *research* payment accounts.

[**Note:** article 13(2) of the *MiFID Delegated Directive*]

Research for the purposes of research payment accounts

- 2.3B.21 R A *firm* must only use monies in a *research* payment account established under *COBS* 2.3B.3(2) to pay for *research* or to pay a rebate to *clients* in accordance with *COBS* 2.3B.8(3)(a).
- 2.3B.22 G *Firms* should also consider whether the goods or services they are looking to receive are acceptable minor non-monetary benefits under *COBS* 2.3A.15R or *COBS* 2.3A.18G, which can be received without breaching the inducements *rules* under *COBS* 2.3A.11R(2) or *COBS* 2.3A.12R(2).
- 2.3B.23 G Examples of goods or service that the *FCA* does not regard as *research*, and as a result could not be paid for from *research* payment accounts, include:
- (1) post-trade analytics;
  - (2) price feeds or historical price data that have not been analysed or manipulated in order to present the *firm* with meaningful conclusions;

- (3) services relating to the valuation or performance measurement of portfolios;
- (4) seminar fees;
- (5) *corporate access services*;
- (6) subscriptions for publications;
- (7) travel, accommodation or entertainment costs;
- (8) order and execution management systems;
- (9) membership fees to professional associations; and
- (10) direct *money* payments.

2.3B.24 G A *firm* should not enter into any arrangements relating to the receipt of, and payment for, third party *research*, whether acquired in accordance with COBS 2.3B.3R(1) or (2), that would compromise its ability to meet its best execution obligations as applicable under COBS 11.2A.

## 2.3C Research and execution services

### Application

- 2.3C.1 R This section applies to an *investment firm* providing execution services to:
- (1) an *investment firm*; or
  - (2) a *UCITS management company*; or
  - (3) a *full-scope UK AIFM*; or
  - (4) a *small authorised UK AIFM*; or
  - (5) a *residual CIS operator*; or
  - (6) an *incoming EEA AIFM branch*.

Requirement on a firm that executes orders and provides research to price and supply services separately

- 2.3C.2 R A *firm* providing execution services must:
- (1) identify separate charges for their execution services that only reflect the cost of executing the transaction;
  - (2) subject each other benefit or service which it provides to *persons*

listed in *COBS* 2.3C.1R(1)-(6) to a separately identifiable charge;  
and

- (3) ensure that the supply of, and charges for, other benefits or services under (2) is not influenced or conditioned by levels of payment for execution services.

[**Note:** article 13(9) of the *MiFID Delegated Directive*]

2.3C.3 R A *firm* providing both execution and *research* services must price and supply them separately.

2.3C.4 G Compliance with *COBS* 2.3C.2R is intended to enable *firms* subject to *COBS* 2.3A.11R(2) and *COBS* 2.3A.12R(2) to comply with their obligations not to accept and retain fees, commissions or any monetary or non-monetary benefits paid or provided by any third party or a *person* acting on behalf of a third party in relation to the provision of the service to *clients*.

[**Note:** recital 26 to the *MiFID Delegated Directive*]

Amend the following as shown.

## 2.4 Agent as client and reliance on others

...

Reliance on other investment firms: MiFID and equivalent business

2.4.4 R (1) This *rule* applies if a *firm* (F1), in the course of performing *MiFID* or *equivalent third country business*, receives an instruction to ~~perform~~ provide an *investment* or *ancillary service* on behalf of a *client* (C) through another *firm* (F2), if F2 is:

...

...

(3) F2 will remain responsible for:

(a) ...

(b) the ~~appropriateness~~ suitability for C of any advice or recommendations provided to C.

...

[**Note:** article ~~20~~ 26 of *MiFID*]



- 2.4.5 G (1) If F1 is required to perform a suitability assessment or an appropriateness assessment under *COBS 9 9A* or *COBS 10 10A*, it may rely upon a suitability assessment performed by F2, if F2 was subject to the requirements for assessing suitability in *COBS 9 9A* (excluding the basic advice *rules*) or equivalent requirements in another *EEA State* in performing that assessment.
- (2) If F1 is required to perform an appropriateness assessment under *COBS 10 10A*, it may rely upon an appropriateness assessment performed by F2, if F2 was subject to the requirements for assessing appropriateness in *COBS 10.2 10A.2* or equivalent requirements in another *EEA State* in performing that assessment.

...

### 3 Client Categorisation

#### 3.1 Application

...

3.1.2 G ...

- 3.1.2A G (1) This chapter contains a number of provisions marked with the status letters “EU”, which have been selectively reproduced from the *MiFID Org Regulation*.
- (2) Where this chapter reproduces provisions of the *MiFID Org Regulation* they are directly applicable to *MiFID Org Regulation firms* in relation to their *MiFID business*. Such *firms* should use the Official Journal of the European Union for a comprehensive statement of their obligations under the *MiFID Org Regulation*.
- (3) The purpose of *COBS 3.1.2BR* is that these provisions are also applied in relation to other business and to other *firms* to which this chapter applies, as stated in that *rule*.
- 3.1.2B R (1) Subject to (2) and to *COBS 3.1.3R*, in this chapter provisions marked “EU” apply to a *firm’s* business other than *MiFID business* as if they were *rules*.
- (2) Any references within those provisions marked “EU” to other provisions of *EU* law must be interpreted in light of the purpose of this *rule*.
- 3.1.2C G (1) *COBS 3.1.2BR(2)* has the effect that, where a reproduced provision of an article of the *MiFID Org Regulation* includes a reference or cross reference to another part of the *MiFID Org Regulation*, that

reference or cross reference is given the same meaning for the purposes of COBS 3.1.2BR.

- (2) Firms subject COBS 3.1.2BR should use the text of the preamble to any relevant procession marked “EU” in order to interpret any such references or cross-references.

...

#### Mixed business

3.1.4 R If a *firm* conducts business for a *client* involving both:

- (1) MiFID or equivalent third country business; and  
 (2) other *regulated activities* subject to this chapter:

it must categorise that *client* for such business in accordance with the provisions in this chapter that apply to MiFID or equivalent third country business. [deleted]

3.1.4A G Where a *firm* conducts business for a *client* involving both:

- (1) MiFID or equivalent third country business; and  
 (2) other *regulated activities* subject to this chapter,

it should categorise that *client* for such business as required in COBS 3.1.2BR which has the effect of requiring categorisation in accordance with the provisions in this chapter that apply to MiFID or equivalent third country business.

- 3.1.5 G (1) For example, the ~~requirement~~ guidance at COBS 3.1.4AG concerning mixed business will apply if a *MiFID investment firm* advises a *client* on whether to invest in a *scheme* or a *life policy*. This is because the former is within the scope of *MiFID* and the latter is not. ~~In such a case, the *MiFID client* categorisation requirements prevail.~~ The *MiFID client* categorisation requirements apply to both activities, in accordance with COBS 3.1.2BR.
- (2) The ~~requirement~~ guidance at COBS 3.1.4AG does not apply where the *MiFID or equivalent third country business* is provided separately from the other *regulated activities*. Where this is the case, in accordance with *Principle 7* (communications with clients) the basis on which the different activities will be performed, including any differences in the categorisation that apply, should be made clear to the *client*.

...

### 3.2 Clients

## General definition

- 3.2.1 R (1) A *person* to whom a *firm* provides, intends to provide or has provided:
- (a) a service in the course of carrying on a *regulated activity*; or
  - (b) in the case of *MiFID* or *equivalent third country business*, an *ancillary service*, is a “client” of that *firm*; .
- (2) A “client” includes a potential client.
- (3) In relation to the *financial promotion rules*, a *person* to whom a *financial promotion* is or is likely to be *communicated* is a “client” of a *firm* that *communicates* or *approves* it.
- (4) A client of an *appointed representative* or, if applicable, a *tiered agent* is a “client” of the *firm* for whom that *appointed representative*, or *tiered agent*, acts or intends to act in the course of business for which that *firm* has accepted responsibility under the *Act* or *MiFID* (see sections 39 and 39A of the *Act* and *SUP* 12.3.5R).

[**Note:** article 4(1)(10) (9) of *MiFID*]

...

### 3.3 General notifications

- 3.3.1 R ~~A *firm* must:~~
- (1) ~~notify a new *client* of its categorisation as a *retail client*, *professional client*, or *eligible counterparty* in accordance with this chapter; and~~
  - (2) ~~prior to the provision of services, inform a *client* in a *durable medium* about:~~
    - (a) ~~any right that the *client* has to request a different categorisation; and~~
    - (b) ~~any limitations to the level of *client* protection that such a different categorisation would entail. [deleted]~~

[**Note:** paragraph 2 of section 1 of annex II to *MiFID* and articles 28(1) and (2) and the second paragraph of article 50(2) of the *MiFID implementing Directive*]

- 3.3.1A EU Articles 45(1) and (2) of the *MiFID Org Regulation* require *firms* to provide *clients* with specified information concerning *client* categorisation.

- 45 (1) Investment firms shall notify new clients, and existing clients that the investment firm has newly categorised as required by Directive 2014/65/EU, of their categorisation as a retail client, a professional client or an eligible counterparty in accordance with that Directive.
- (2) Investment firms shall inform clients in a durable medium about any right that client has to request a different categorisation and about any limitations to the level of client protection that a different categorisation would entail.

[**Note:** articles 45(1) and (2) of the *MiFID Org Regulation*]

3.3.1B R The information referred to in COBS 3.3.1AEU45(2) must be provided to clients prior to any provision of services.

[**Note:** paragraph 2 of section I of annex II to *MiFID*]

...

### 3.4 Retail clients

3.4.1 R A *retail client* is a *client* who is not a *professional client* or an *eligible counterparty*.

[**Note:** article 4(1)(~~12~~) (11) of *MiFID*]

...

### 3.5 Professional clients

3.5.1 R A *professional client* is a *client* that is either a *per se professional client* or an *elective professional client*.

[**Note:** article 4(1)(~~11~~) (10) of *MiFID*]

Per se professional clients

3.5.2 R Each of the following is a *per se professional client* unless and to the extent it is an *eligible counterparty* or is given a different categorisation under this chapter:

...

(3) in relation to business that is not *MiFID* or *equivalent third country business* a large undertaking meeting any of the following conditions:

...

(e) a trustee of an *occupational pension scheme* or *SSAS*, or a trustee or *operator* of a *personal pension scheme* or

*stakeholder pension scheme* where the scheme has (or has had at any time during the previous two years):

...

(ii) assets under management of at least £10 million (or its equivalent in any other currency at the relevant time);

(f) ~~a local authority or public authority.~~

(4) a national or regional government, including a public body that manages public debt at national or regional level, a central bank, an international or supranational institution (such as the World Bank, the IMF, the ECP, the EIB) or another similar international organisation;

...

3.5.2A R ~~In relation to *MiFID* or equivalent third country business a local authority or a public authority is not likely to be a regional government for the purposes of *COBS* 3.5.2R(4). In the *FCA*'s opinion, a local authority may be a *per se* professional client for those purposes if it meets the text for large undertakings in *COBS* 3.5.2R(2). [deleted]~~

3.5.2B R A firm must categorise a local public authority or municipality which (in either case) does not manage public debt as a *retail client*, unless it is permitted to treat such a person as an *elective professional client* in accordance with *COBS* 3.5.3AR.

3.5.2C G As a result of *COBS* 3.5.2BR, a local public authority or municipality which (in either case) does not manage public debt should not be treated as a *per se* professional client.

Elective professional clients

3.5.3 R A firm may treat a *client* other than a local public authority or municipality as an *elective professional client* if it complies with (1) and (3) and, where applicable, (2):

...

3.5.3A R (1) A firm may treat a local public authority or municipality as an *elective professional client* if it complies with *COBS* 3.5.3R(1) and *COBS* 3.5.3R(3) and, in addition, paragraph (2) of this rule.

(2) In the course of the assessment under *COBS* 3.5.3R(1), the criteria in paragraph (b) and either paragraph (a) or (c) are satisfied (the “quantitative test”):

(a) the *client* has carried out transactions, in significant size, on the relevant market at an average frequency of ten per

quarter over the previous four quarters;

- (b) the size of the *client's financial instrument* portfolio defined as including cash deposits and *financial instruments*, exceeds £15,000,000;
- (c) the *client* works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the provision of services envisaged.

- 3.5.3B R (1) This rule applies where a *firm* is subjecting a local public authority or municipality to the tests and following the procedure required under COBS 3.5.3AR in respect of the *firm's* business carried on in relation to that *person's*:
- (a) business in the course of or connected to its administration of a *pension scheme*; and
  - (b) other business as a local public authority or municipality.
- (2) A *firm* must apply the qualitative and quantitative tests required under COBS 3.5.3R and COBS 3.5.3AR separately and independently in relation to the *client's* business under (1)(a) and (1)(b).
- (3) A *firm* must follow the procedure in COBS 3.5.3R(3) separately and independently in relation to the *client's* business under (1)(a) and (1)(b).

3.5.3C G As a result of COBS 3.5.2BR, COBS 3.5.3BR and depending on the outcome of the qualitative and quantitative tests required under COBS 3.5.3R and COBS 3.5.3AR a *firm* may be required to categorise a local public authority or municipality differently in relation to the two sorts of business described at COBS 3.5.3BR(1)(a) and (b).

...

3.5.9 R ...

[**Note:** fourth paragraph of section II.2 of annex II to *MiFID* and article 28(1) of the *MiFID implementing Directive*]

### 3.6 Eligible counterparties

3.6.1 R ...

[**Note:** article 24~~30~~(1) of *MiFID*]

Per se eligible counterparties

3.6.2 R Each of the following is a *per se eligible counterparty* (including an entity that is not from an *EEA State* that is equivalent to any of the following) unless and to the extent it is given a different categorisation under this chapter:

...

(8) a national government or its corresponding office, including a public body that deals with ~~the~~ public debt at national level;

...

[**Note:** first paragraph of article 24 30(2) and first paragraph of article 24 30(4) of *MiFID*]

...

#### Elective eligible counterparties

3.6.4 R A firm may treat a client as an elective eligible counterparty in relation to business other than MiFID or equivalent third country business if:

(1) the *client* is an undertaking and:

(a) is a *per se professional client* (except for a *client* that is only a *per se professional client* because it is an institutional investor under *COBS 3.5.2R(5)*) and, ~~in relation to business other than MiFID or equivalent third country business:~~

(i) ...

(ii) meets the criteria in the *rule* on meeting two quantitative tests (*COBS 3.5.2R(3)(b)*); ~~or~~ and

(b) ~~Requests such categorisation and is an elective professional client, but only in respect of the services or transactions for which it could be treated as a professional client: and~~

(2) ~~the firm has, in relation to MiFID or equivalent third country business, obtained express confirmation from the prospective counterparty that it agrees to be treated as an eligible counterparty the firm adheres to the procedure under COBS 3.6.4BEU.~~

...

3.6.4A EU Article 71(1) of the MiFID Org Regulation explains which sorts of per se professional clients may be treated as elective eligible counterparties in relation to MiFID or equivalent third country business.

71 (1) In addition to the categories which are explicitly set out in Article 30(2) of Directive 2014/65/EU, Member States may recognise as eligible counterparty, in accordance with

Article 30(3) of that Directive, an undertaking failing within a category of clients who are to be considered professional clients in accordance with paragraphs 1, 2 and 3 of Section I of Annex II to that Directive.

3.6.4B EU Article 71(5) of the *MiFID Org Regulation* sets out the procedure to be followed where a *client* requests to be treated as an *eligible counterparty*.

71 (5) Where a client requests to be treated as an eligible counterparty, in accordance with Article 30(3) of Directive 2014/65/EU, the following procedure shall be followed:

(a) the investment firm shall provide the client with a clear written warning of the consequences for the client of such a request, including the protections they may lose;

(b) the client shall confirm in writing the request to be treated as an eligible counterparty either generally or in respect of one or more investment services or a transaction or type of transaction or product and that they are aware of the consequences of the protection they may have lost as a result of the request.

...

3.6.6 R ...

[**Note:** second paragraph of article 2430(3) of *MiFID*]

Client and firm located in different jurisdictions

3.6.7 R ...

[**Note:** first paragraph of article 2430(3) of *MiFID*]

### **3.7 Providing clients with a higher level of protection**

3.7.1 R ...

[**Note:** second paragraph of article 2430(2) of, and second paragraph of section I of annex II to, *MiFID* and the second paragraph of article 50(2) of the *MiFID implementing Directive*]

3.7.2 G ...

[**Note:** third paragraph of section I and fourth paragraph of section II.2 of annex II to *MiFID* and article 50(2) of the *MiFID implementing Directive*]

3.7.3 R ~~A firm may, either on its own initiative or at the request of the client~~



concerned:

- (1) ~~treat as a *professional client* or a *retail client* a *client* that might otherwise be categorised as a *per se eligible counterparty*;~~
- (2) ~~treat as a *retail client* a *client* that might otherwise be categorised as a *per se professional client*;~~

and if it does so, the *client* will be re-categorised accordingly. Where applicable, this re-categorisation is subject to the requirement for a written agreement in *COBS 3.7.5R*. [deleted]

[~~Note: second paragraph of article 24(2) of, and second paragraph of section I of annex II to, *MiFID* and article 28(3) and the second paragraph of article 50(2) of the *MiFID implementing Directive*~~]

3.7.3A    EU    Article 45(3) of the *MiFID Org Regulation* sets out provisions in respect of giving *clients* a higher level of protection.

- 45    (3)    Investment firms may, either on their own initiative or at the request of the client concerned treat a client in the following manner:
- (a)    as a professional or retail client where that client might otherwise be classified as an eligible counterparty pursuant to Article 30(2) of Directive 2014/65/EU;
  - (b)    a retail client where that client that is considered as a professional client pursuant to Section I of Annex II to Directive 2014/65/EU.

3.7.2B    EU    Article 71(2) to (4) of the *MiFID Org Regulation* sets out provisions applying to *eligible counterparties* requesting a higher level of protection.

- 71    (2)    Where, pursuant to the second subparagraph of Article 30(2) of that Directive 2014/65/EC, an eligible counterparty requests treatment as a client whose business with an investment firm is subject to Articles 24, 25, 27 and 28 of that Directive, the request should be made in writing, and shall indicate whether the treatment as retail client or professional client refers to one or more investment services or transactions, or one or more types of transaction or product.
- (3)    Where an eligible counterparty requests treatment as a client whose business with an investment firm is subject to Articles 24, 25, 27 and 28 of Directive 2014/65/EC, but does not expressly request treatment as a retail client, the firm shall treat that eligible counterparty as a professional client.

(4) Where the eligible counterparty expressly requests treatment as a retail client, the investment firm shall treat the eligible counterparty as a retail client, applying the provisions in respect of requests of non-professional treatment specified in the second, third and fourth subparagraphs of Section I of Annex II to Directive 2014/65/EC.

3.7.4 R ~~If a *per se* eligible counterparty requests treatment as a client whose business with the firm is subject to conduct of business protections, but does not expressly request treatment as a retail client and the firm agrees to that request, the firm must treat that eligible counterparty as a professional client. [deleted]~~

~~[Note: first paragraph of article 50(2) of the MiFID implementing Directive]~~

3.7.5 R (1) If, in relation to MiFID or equivalent third country business a *per se* professional client ~~or a *per se* eligible counterparty~~ requests treatment as a retail client, the client will be classified as a retail client if it enters into a written agreement with the firm to the effect that it will not be treated as a professional client or eligible counterparty for the purposes of the applicable conduct of business regime.

(2) This agreement must specify the scope of the re-categorisation, such as whether it applies to one or more particular services or transactions, to one or more types of product or transaction or to one or more rules.

~~[Note: fourth paragraph of section I of annex II to MiFID and second paragraph of article 50(2) of the MiFID implementing Directive]~~

...

3.7.7 G ...

[Note: second paragraph of article 2430(2) of MiFID]

...

### 3.8 Policies, procedures and records

...

#### Records

3.8.2 R ...

[Note: article 51(3)16(6) of the MiFID implementing Directive MiFID]

...

## 4. Communicating with clients, including financial promotions

### 4.1 Application

Who? What?

- 4.1.1 R This chapter applies to a *firm*:
- (1) communicating with a *client* in relation to its *designated investment business*;
  - ...
  - (3) when a *MiFID investment firm* or a *credit institution* is communicating in connection with selling, or advising *clients* in relation to, *structured deposits* as specified by *COBS 1.1.1AAR*.
- ...
- 4.1.4 G (1) In *COBS 4.3.1R*, *COBS 4.5.8R* and *COBS 4.7.1R*, the defined terms "*financial promotion*" and "*direct offer financial promotion*" include, in relation to ~~*MiFID or equivalent third country business*~~ *MiFID, equivalent third country or optional exemption business*, all communications that are marketing communications within the meaning of *MiFID*.
- (2) In the case of ~~*MiFID or equivalent third country business*~~ *MiFID, equivalent third country or optional exemption business*, certain requirements in this chapter are subject to an exemption for the communication of a *third party prospectus* in certain circumstances (see recital 73 of the *MiFID Org Regulation*). This has a similar effect to the exemption in article 70(1)(c) of the *Financial Promotion Order*, which is referred to in the definition of an *excluded communication*.
- ...
- 4.1.5 G (1) A *firm* communicating with an *eligible counterparty* should have regard to the application of *COBS* to *eligible counterparty business* (*COBS 1 Annex 1 Part 1*).
- (2) ~~This chapter does not apply in relation to communicating with an *eligible counterparty* other than the section on compensation information (see *COBS 4.4*) but elements of the requirements in *PRIN* may apply.~~

4.1.6 G *Approving a financial promotion without communicating it (which includes causing it to be communicated) is not ~~MiFID or equivalent third country business~~ MiFID, equivalent third country or optional exemption business. Communicating a financial promotion to a person, such as a corporate finance contact or a venture capital contact, who is not a client within the meaning of COBS 3.2.1R(1), COBS 3.2.1R(2) or COBS 3.2.1R(4) in respect of the ~~MiFID or equivalent third country business~~ MiFID, equivalent third country or optional exemption business to which the financial promotion relates, is also not ~~MiFID or equivalent third country business~~ MiFID, equivalent third country or optional exemption business. Further guidance on what amounts to *MiFID business* may be found in PERG 13.*

4.1.7 G *A reference in this chapter to ~~MiFID or equivalent third country business~~ MiFID, equivalent third country or optional exemption business includes a reference to communications that occur before an agreement to perform services in relation to ~~MiFID or equivalent third country business~~ MiFID, equivalent third country or optional exemption business.*

[**Note:** see recital 82 16 to the ~~MiFID implementing Directive~~ MiFID Org Regulation]

...

## 4.2 Fair, clear and not misleading communications

The fair, clear and not misleading rule

4.2.1 R (1) *A firm must ensure that a communication or a financial promotion is fair, clear and not misleading.*

(2) *This rule applies ~~in relation to~~:*

(a) *to a communication by the firm to a ~~client~~ customer in relation to designated investment business other than a third party prospectus;*

(aa) *in relation to ~~MiFID or equivalent third country business~~, a communication to an eligible counterparty other than a third party prospectus.*

...

(3) *As part of complying with (1), a firm must take into account the nature of the client.*

[**Note:** ~~article 19(2) of MiFID, recital 52 to the MiFID implementing Directive~~ article 24(3) and article 30(1) of MiFID, recital 73 to the MiFID Org Regulation and article 77 of the *UCITS Directive*]

4.2.2 G (1) *The fair, clear and not misleading rule applies in a way that is appropriate and proportionate taking into account the means of*

communication, ~~and~~ the information the communication is intended to convey and, the nature of the *client* and of its business, if any. So a communication addressed to a *professional client* or an eligible counterparty may not need to include the same information, or be presented in the same way, as a communication addressed to a *retail client*.

(2) ...

[Note: article 30(1) of *MiFID* and recital 65 to the *MiFID Org Regulation*]

...

### 4.3 Financial promotions to be identifiable as such

4.3.1 R (1) ...

[Note: article ~~49(2)~~ 24(3) of *MiFID* and article 77 of the *UCITS Directive*]

(2) ~~If a financial promotion relates to a firm's *MiFID* or equivalent third country business~~ *MiFID, equivalent third country or optional exemption business*, this rule does not apply to the extent that the financial promotion is a *third party prospectus*.

...

...

### 4.5 Communicating with retail clients (non-MiFID provisions)

Application

4.5.1 R (1) Subject to (2) and (3), this section applies to a *firm* in relation to:

- (a) the provision of information in relation to its *designated investment business*; and
- (b) the *communication* or *approval* of a *financial promotion*;

where such information or *financial promotion* is addressed to, or disseminated in such a way that it is likely to be received by, a *retail client*.

(2) ~~If a communication relates to a firm's *MiFID* or equivalent third country business, this section does not apply.~~ This section does not apply to a *firm* communicating in relation to its *MiFID, equivalent third country or optional exemption business*.

- ~~(a) to the extent that it is a *third party prospectus*;~~

~~(b) if it is *image advertising*.~~

(3) ~~If a communication relates to a *firm's* business that is not *MiFID* or *equivalent third-country business*, this~~ This section does not apply in relation to a communication:

...

General rule

4.5.2 R A *firm* must ensure that information:

- (1) includes the name of the *firm*;
- (2) is accurate and ~~in particular does not emphasise~~ always gives a fair and prominent indication of any relevant risks when referencing any potential benefits of *relevant business* or a *relevant investment* without also giving a fair and prominent indication of any relevant risks;
- (3) is sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received; ~~and~~
- (4) does not disguise, diminish or obscure important items, statements or warnings;
- (5) uses a font size in the indication of relevant risks that is at least equal to the predominant font size used throughout the information provided, as well as a layout that ensures that such indication is prominent;
- (6) is consistently presented in the same language throughout all forms of information and marketing materials that are provided to each *client*, unless the *client* has agreed to receive information in more than one language; and
- (7) is up-to-date and relevant to the means of communication used.

~~[Note: article 27(2) of the *MiFID* implementing Directive]~~

...

4.5.5 G When communicating information, a *firm* should consider whether omission of any relevant fact will result in the information being insufficient, unclear, unfair or misleading.

Comparative information

4.5.6 R (1) If information compares *relevant business*, *relevant investments*, or persons who carry on *relevant business*, a *firm* must ensure that:

- ~~(a) the comparison is meaningful and presented in a fair and balanced way; and~~
- ~~(b) in relation to *MiFID or equivalent third country business*;~~
  - ~~(i) the sources of the information used for the comparison are specified; and~~
  - ~~(ii) the key facts and assumptions used to make the comparison are included.~~

~~(2) In this rule, in relation to *MiFID or equivalent third country business*, ancillary services are to be regarded as relevant business. [deleted]~~

~~[Note: article 27(3) of the *MiFID implementing Directive*]~~

Referring to tax

4.5.7 R (1) ...

~~[Note: article 27(7) of the *MiFID implementing Directive*]~~

~~(2) This rule applies in relation to *MiFID or equivalent third country business* or, otherwise, to a financial promotion. However, it does not apply to a financial promotion except to the extent that it relates to:~~

- ~~(a) [deleted]~~
- ~~(b) a pure protection contract that is a long-term care insurance contract.~~

Consistent financial promotions

4.5.8 R (1) A firm must ensure that information contained in a financial promotion is consistent with any information the firm provides to a retail client in the course of carrying on designated investment business or, in the case of *MiFID or equivalent third country business*, ancillary services.

~~[Note: article 29(7) of the *MiFID implementing Directive*]~~

~~(2) This rule does not apply to a financial promotion to the extent that it relates to:~~

- ~~(a) [deleted]~~
- ~~(b) a pure protection contract that is a long-term care insurance contract.~~

...

After COBS 4.5 (Communicating with retail clients (non-MiFID provisions)) insert the following new section. All the text is new and is not underlined.

**4.5A Communicating with clients (including past, simulated past and future performance) (MiFID provisions)**

Application

- 4.5A.1 R (1) This section applies to a *firm* in relation to:
- (a) the provision of information; or
  - (b) the *communication* of a *financial promotion*,  
which relates to the *firm's MiFID, equivalent third country or optional exemption business*.
- (2) This section does not apply to a communication:
- (a) to the extent that it is a *third party prospectus*; or
  - (b) if it is *image advertising*.

[**Note:** recital 65 to *MiFID* and recital 73 to the *MiFID Org Regulation*]

- 4.5A.2 R In relation to:
- (a) *MiFID optional exemption business*; and
  - (b) the *equivalent business of a third country investment firm*,
- provisions in this chapter marked “EU” apply as if they were *rules*.

General requirements

- 4.5A.3 EU 44(1) Investment firms shall ensure that all information they address to, or disseminate in such a way that it is likely to be received by, retail or professional clients or potential retail or professional clients, including marketing communications, satisfies the conditions laid down in paragraphs 2 to 8.
- 44(2) Investment firm shall ensure that the information referred to in paragraph 1 complies with the following conditions:
- (a) the information includes the name of the investment firm,
  - (b) the information is accurate and always gives a fair and prominent indication of any relevant risks when referencing any potential benefits of an investment service or financial



instrument,

- (c) the information uses a font size in the indication of relevant risks that is at least equal to the predominant font size used throughout the information provided, as well as a layout ensuring such indication is prominent,
- (d) the information is sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received,
- (e) the information does not disguise, diminish or obscure important items, statements or warnings,
- (f) the information is consistently presented in the same language throughout all forms of information and marketing materials that are provided to each client, unless the client has accepted to receive information in more than one language,
- (g) the information is up-to-date and relevant to the means of communication used.

[**Note:** article 44(1) and (2) of the *MiFID Org Regulation*]

- 4.5A.4 G The name of the *firm* may be a trading name or shortened version of the legal name of the *firm*, provided the *client* can identify the *firm* communicating the information.
- 4.5A.5 G In deciding whether, and how, to communicate information to a particular target audience, a *firm* should take into account the nature of the product or business, the risks involved, the *client's* commitment, the likely information needs of the average recipient, and the role of the information in the sales process.
- 4.5A.6 G When communicating information, a *firm* should consider whether omission of any relevant fact will result in the information being insufficient, unclear, unfair or misleading.

Comparative information

- 4.5A.7 EU 44(3) Where the information compares investment or ancillary services, financial instruments, or persons providing investment or ancillary services, investment firms shall ensure that the following conditions are satisfied:
  - (a) the comparison is meaningful and presented in a fair and balanced way;
  - (b) the sources of the information used for the comparison are specified;

- (c) the key facts and assumptions used to make the comparison are included.

[**Note:** article 44(3) of the *MiFID Org Regulation*]

#### Referring to tax

- 4.5A.8 EU 44(7) Where the information refers to a particular tax treatment, it shall prominently state that the tax treatment depends on the individual circumstances of each client and may be subject to change in the future.

[**Note:** article 44(7) of the *MiFID Org Regulation*]

#### Consistent financial promotions

- 4.5A.9 EU 46(5) Investment firms shall ensure that information contained in a marketing communication is consistent with any information the firm provides to clients in the course of carrying on investment and ancillary services.

[**Note:** article 46(5) of the *MiFID Org Regulation*]

#### Past performance

- 4.5A.10 EU 44(4) Where the information contains an indication of past performance of a financial instrument, a financial index or an investment service, investment firms shall ensure that the following conditions are satisfied:
- (a) that indication is not the most prominent feature of the communication;
  - (b) the information must include appropriate performance information which covers the preceding 5 years, or the whole period for which the financial instrument has been offered, the financial index has been established, or the investment service has been provided where less than five years, or such longer period as the firm may decide, and in every case that performance information is based on complete 12-month periods;
  - (c) the reference period and the source of information is clearly stated;
  - (d) the information contains a prominent warning that the figures refer to the past and that past performance is not a reliable indicator of future results;
  - (e) where the indication relies on figures denominated in a currency other than that of the Member State in which the

retail client or potential retail client is resident, the currency is clearly stated, together with a warning that the return may increase or decrease as a result of currency fluctuations;

- (f) where the indication is based on gross performance, the effect of commissions, fees or other charges are disclosed.

[Note: article 44(4) of the *MiFID Org Regulation*]

- 4.5A.11 G The obligations relating to describing performance should be interpreted in the light of their purpose and in a way that is appropriate and proportionate taking into account the means of communication and the information the communication is intended to convey. For example, a *periodic statement* in relation to *managing investments* that is sent in accordance with the *rules* on reporting information to *clients* (see *COBS 16* and *COBS 16A*) may include past performance as its most prominent feature.

[Note: recital 65 to the *MiFID Org Regulation*]

#### Simulated past performance

- 4.5A.12 EU 44(5) Where the information includes or refers to simulated past performance, investment firms shall ensure that the information relates to a financial instrument or a financial index, and the following conditions are satisfied:
- (a) the simulated past performance is based on the actual past performance of one or more financial instruments or financial indices which are the same as, or substantially the same as, or underlie, the financial instrument concerned;
  - (b) in respect of the actual past performance referred to in point (a), the conditions set out in points (a) to (c), (e) and (f) of paragraph 4 are satisfied;
  - (c) the information contains a prominent warning that the figures refer to simulated past performance and that past performance is not a reliable indicator of future performance.

[Note: article 44(5) of the *MiFID Org Regulation*]

- 4.5A.13 G For the purposes of *COBS 4.5A.12EU*, the conditions referred to in article 44(5)(b) can be found reproduced in *COBS 4.5A.10EU*.

#### Future performance

- 4.5A.14 EU 44(6) Where the information contains information on future performance, investment firms shall ensure that the following conditions are satisfied:
- (a) the information is not based on or refer to simulated past

performance;

- (b) the information is based on reasonable assumptions supported by objective data;
- (c) where the information is based on gross performance, the effect of commissions, fees or other charges is disclosed;
- (d) the information is based on performance scenarios in different market conditions (both negative and positive scenarios), and reflects the nature and risks of the specific types of instruments included in the analysis;
- (e) the information contains a prominent warning that such forecasts are not a reliable indicator of future performance.

[Note: article 44(6) of the *MiFID Org Regulation*]

- 4.5A.15 G A *firm* should not provide information on future performance if it is not able to obtain the objective data needed to comply with the requirements regarding information on future performance in *COBS 4.5A.14EU*. For example, objective data in relation to *EIS shares* may be difficult to obtain.

Information that uses the name of any competent authority

- 4.5A.16 EU 44(8) The information shall not use the name of any competent authority in such a way that would indicate or suggest endorsement or approval by that authority of the products or services of the investment firm.

[Note: article 44(8) of the *MiFID Org Regulation*]

Amend the following as shown.

#### 4.6 Past, simulated past and future performance (non-MiFID provisions)

Application

- 4.6.1 R (1) Subject to (2) and (3), this section applies to a *firm* in relation to:

- (a) ~~the provision of information in relation to its *MiFID* or equivalent third country business; [deleted]~~
- (b) the communication or approval of a *financial promotion*;

where such information or *financial promotion* is addressed to, or disseminated in such a way that it is likely to be received by, a *retail client*.

- (2) ~~If a communication relates to a firm's MiFID or equivalent third country business, this section does not apply: This section does not apply to a firm communicating in relation to its MiFID, equivalent third country or optional exemption business~~
- (a) ~~to the extent that the communication is a third party prospectus;~~
- (b) ~~if it is image advertising.~~
- (3) ~~If a communication relates to a firm's business that is not MiFID or equivalent third country business, this~~ This section does not apply in relation to a communication:
- ...
- (d) to the extent that it relates to a *deposit* that is not a *structured deposit* (see also *COBS 4.1.1R(3)*);
- ...

Past performance

- 4.6.2 R A *firm* must ensure that information that contains an indication of past performance of *relevant business*, a *relevant investment* or a financial index, satisfies the following conditions:
- ...
- (2) the information includes appropriate performance information which covers ~~at least the immediately~~ the preceding five years, or the whole period for which the investment has been offered, the financial index has been established, or the service has been provided ~~if~~ (where less than five years, or such longer period as the firm may decide), and in every case that performance information must be based on ~~and show~~ complete 12-month periods;
- ...
- ~~[Note: article 27(4) of the MiFID implementing Directive]~~
- ...

Simulated past performance

- 4.6.6 R A *firm* must ensure that information that contains an indication of simulated past performance of *relevant business*, a *relevant investment* or a financial index, satisfies the following conditions:
- (1) ...

- (2) the simulated past performance is based on the actual past performance of one or more investments or financial indices which are the same as, substantially the same as, or underlie, the investment concerned;
- (3) in respect of the actual past performance referred to in (2), the conditions set out in paragraphs (1) to (3), (5) and (6) of the *rule* on past performance (*COBS 4.6.2R*) are complied with; and

...

~~[Note: article 27(5) of the *MiFID implementing Directive*]~~

#### Future performance

- 4.6.7 R (1) A *firm* must ensure that information that contains an indication of future performance of *relevant business*, a *relevant investment*, a *structured deposit* or a financial index, satisfies the following conditions:
- ...
- (c) ~~it discloses the effect of commissions, fees or other charges if~~ where the indication is based on gross performance, the effect of commissions, fees or other charges is disclosed; and
  - (ca) it is based on performance scenarios in different market conditions (both negative and positive scenarios), and reflects the nature and risks of the specified types of investments included in the analysis; and
  - (d) ...
- (2) ~~Other than in relation to *MiFID* or equivalent third country business, this~~ This rule only applies in relation to financial promotions that relate to a financial instrument (or a financial index that relates exclusively to financial instruments) or a structured deposit.

~~[Note: article 27(6) of the *MiFID implementing Directive*]~~

...

## 4.7 Direct offer financial promotions

### Application

- 4.7.-1 G (1) *COBS 4.7.-1AEU* to *COBS 4.7.1R* contain provisions on the communication of *direct offer financial promotions*.
- (2) In broad terms:

- (a) COBS 4.7.-1AEU is relevant to a firm communicating a direct offer financial promotion in relation to its MiFID, equivalent third country or optional exemption business; and
  - (b) COBS 4.7.1R is relevant to a firm communicating a direct offer financial promotion that does not relate to its MiFID, equivalent third country or optional exemption business.
- (3) However, a MiFID investment firm, third country investment firm or MiFID optional exemption firm which is subject to the requirements in COBS 4.7.1-1AEU may be subject to the rule in COBS 4.7.1R to the extent that it communicates a direct offer financial promotion:
- (a) which is not a marketing communication; or
  - (b) which does not relate to its MiFID, equivalent third country or optional exemption business.

Direct offer financial promotions relating to MiFID, equivalent third country or optional exemption business

<u>4.7.-1A</u>	<u>EU</u>	<u>46</u>	<p>(6) <u>Marketing communications containing an offer or invitation of the following nature and specifying the manner of response or including a form by which any response may be made, shall include such of the information referred to in Articles 47 to 50 as is relevant to that offer or invitation:</u></p> <ul style="list-style-type: none"> <li>(a) <u>an offer to enter into an agreement in relation to a financial instrument or investment service or ancillary service with any person who responds to the communication;</u></li> <li>(b) <u>an invitation to any person who responds to the communication to make an offer to enter into an agreement in relation to a financial instrument or investment service or ancillary service.</u></li> </ul> <p><u>However, the first subparagraph shall not apply if, in order to respond to an offer or invitation contained in the marketing communication, the potential client must refer to another document or documents, which, alone or in combination, contain that information.</u></p>
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[Note: article 46(6) of the MiFID Org Regulation]

4.7.-1B R In relation to:

- (1) MiFID optional exemption business; and
  - (2) the equivalent business of a third country investment firm,
- the provisions in COBS 4.7.-1AEU apply as if they were rules.

4.7.-1C G For the purposes of COBS 4.7.-1AEU, the provisions of articles 47 to 50 of the MiFID Org Regulation can be found reproduced in COBS 6.1-A and COBS 14.3A.

Other direct offer financial promotions

- 4.7.1 R (1) Subject to (3) and (4), a *firm* must ensure that a *direct offer financial promotion* that is addressed to, or disseminated in such a way that it is likely to be received by, a *retail client* contains:
- (a) ~~such of~~ the information referred to in the *rules* on information disclosure (*COBS 6.1.4R, COBS 6.1.6R, COBS 6.1.7R, COBS 6.1.9R, COBS 14.3.2R, COBS 14.3.3R, COBS 14.3.4R and COBS 14.3.5R*) as is relevant to that offer or invitation; and
- ~~[Note: article 29(8) of the MiFID implementing Directive, the rules listed implement Articles 30 to 33 of the MiFID implementing Directive]~~
- (b) ~~if it does not relate to MiFID or equivalent third country business,~~ additional appropriate information about the *relevant business* and *relevant investments* so that the *client* is reasonably able to understand the nature and risks of the *relevant business* and *relevant investments* and consequently to take investment decisions on an informed basis.
- (2) ...
- (3) ~~If This section does not apply in relation to a marketing communication that relates to a firm's MiFID or equivalent third country business, this section does not apply: MiFID, equivalent third country or optional exemption business~~
- (a) ~~to the extent that it is a third party prospectus;~~
  - (b) ~~if it is image advertising.~~
- (4) ~~If a communication relates to a firm's business that is not MiFID or equivalent third country business, this This section does not apply in relation to a communication:~~
- ...



- (5) ~~In this rule, in relation to *MiFID* or equivalent third country business, ancillary services are to be regarded as relevant business.~~  
~~[deleted]~~

Guidance

- 4.7.2 G Although *COBS* 4.7.1R(1)(b) does not generally apply in relation to ~~*MiFID*~~ or equivalent third country business *MiFID, equivalent third country or optional exemption business*, similar requirements may apply under *COBS* ~~2.2~~ 2.2A.

...

Warrants and derivatives

- 4.7.6 R (1) A *firm* must not *communicate* or *approve* a *direct offer financial promotion*:

...

- (c) where the *firm* will not itself be required to comply with the *rules* on appropriateness (see *COBS* 10 and 10A);

...

...

Non-readily realisable securities

- 4.7.7 R ...

- (3) The second condition is that *firm* itself or the *person* who will *arrange* or *deal* in relation to the *non-readily realisable security* will comply with the *rules* on appropriateness (see *COBS* 10 and 10A) or equivalent requirements for any application or order that the *person* is aware, or ought reasonably to be aware, is in response to the *direct offer financial promotion*.

- 4.7.8 R A *firm* may *communicate* or *approve* a *direct-offer financial promotion* relating to a *non-readily realisable security* to or for *communication* to a *retail client* if:

- (1) the *firm* itself will comply with the *suitability rules* (*COBS* 9 and 9A) in relation to the *investment promoted*; or

- (2) the *retail client* has confirmed before the promotion is made that they are a *retail client* of another *firm* that will comply with the *suitability rules* (*COBS* 9 and 9A) in relation to the *investment promoted*; or

...

...

#### 4.10 Systems and controls and approving and communicating financial promotions

...

Approving financial promotions

...

4.10.3 G ...

- (3) *Approving a financial promotion for communication by an unauthorised person is not ~~MiFID or equivalent third country business~~ MiFID, equivalent third country or optional exemption business.*

...

Relying on another firm's confirmation of compliance

4.10.10 R ...

- (2) *This rule does not apply in relation to ~~MiFID or equivalent third country business~~ MiFID, equivalent third country or optional exemption business.*

#### 4.11 Record keeping: financial promotion

4.11.1 R ...

- (4) *If a communication relates to a firm's ~~MiFID or equivalent third country business~~ MiFID, equivalent third country or optional exemption business, this section does not apply:*

...

...

~~[Note: see article 51(3) of the MiFID implementing Directive]~~

4.11.1A G *A MiFID investment firm, third country investment firm or MiFID optional exemption firm should refer to the requirements on record keeping in the MiFID Org Regulation and SYSC 9.*

...

#### 4.12 Restrictions on the promotion of non-mainstream pooled investments

...

## Advice and preliminary assessment of suitability

- 4.12.5 G (1) Where a *firm* communicates any promotion of a *non-mainstream pooled investment* in the context of advice, it should have regard to and comply with its obligations under *COBS 9 or 9A*. *Firms* should also be mindful of the appropriateness requirements in *COBS 10 and 10A* which apply to a wide range of non-advised services.
- (2) ...
- (b) There is no duty to communicate the preliminary assessment of suitability to the *client*. If the *firm* does so, it must not do so in a way that amounts to making a *personal recommendation* unless it complies with the *rules* in *COBS 9 or 9A (as applicable)* on suitability.
- (c) The requirement for a preliminary assessment of suitability does not extend to a full suitability assessment, unless advice is being offered in relation to the *non-mainstream pooled investment* being promoted, in which case the requirements in *COBS 9 or 9A* apply (as applicable). However, it requires that the *firm* ~~take~~ takes reasonable steps to acquaint itself with the *client's* profile and objectives in order to ascertain whether the *non-mainstream pooled investment* under contemplation is likely to be suitable for that *client*. The *firm* should not promote the *non-mainstream pooled investment* to the *client* if it does not consider it likely to be suitable for that *client* following such preliminary assessment.

...

Amend the following as shown. Underlining indicates new text and striking through indicates deleted text.

## 6 Information about the firm, its services and remuneration

### 6.1 Information about the firm and compensation information (non-MiFID provisions)

## Application

- 6.1.1 R (1) ~~This~~ Except in relation to *COBS* 6.1.16R, this section applies to a firm that carries on *designated investment business*, other than *MiFID*, *equivalent third country* or *optional exemption business*, for:
- (a) a *retail client*; and
  - (b) ~~in the case of *MiFID* or *equivalent third country business*, a *client*.~~
- (2) ~~If expressly provided, this section also applies to *ancillary services* not covered by (1), but only in the course of *MiFID* or *equivalent third country business* carried on with or for a *client*. [deleted]~~

...

- 6.1.3 G This section imposes requirements relating to disclosure of information to *clients* that are additional to the general requirement in *COBS* 2.2 and *COBS* 2.2A.

## Information about a firm and its services

- 6.1.4 R A firm must provide a ~~retail~~ *client* with the following general information, if relevant:
- (1) ...
  - (2) ~~in the case of *MiFID* or *equivalent third country business*, the languages in which the *client* may communicate with the *firm*, and receive documents and other information from the *firm*; [deleted]~~
- ...
- (5) ~~in the case of *MiFID* or *equivalent third country business*, the contact address of the *competent authority* that has authorised the *firm*; [deleted]~~
  - (6) if the *firm* is acting through an *appointed representative* or, where applicable, a *tied agent*, a statement of this fact. ~~specifying the *EEA State* in which that *appointed representative* or *tied agent* is registered;~~

[~~Note: article 30(1) of the *MiFID* implementing Directive~~]

...

- 6.1.6 R ...

- (2) If a *firm* proposes to *manage investments* for a ~~*retail*~~ *client*, the *firm* must provide the *client* with such of the following information as is applicable:

...

~~[Note: articles 30(2) and (3) of the MiFID implementing Directive]~~

Information concerning safeguarding of designated investments belonging to clients and client money

- 6.1.7 R (1) A *firm* that holds *designated investments* or *client money* for a ~~*retail*~~ *client* subject to the *custody chapter* or the *client money chapter* must provide that *client* with the following information:
- (a) ...
- (b) if applicable, that the *designated investments* belonging to the ~~*retail*~~ *client* may be held in an omnibus account by a third party and a prominent warning of the resulting risks;
- ...
- (2) A *firm* that holds *designated investments* or *client money* for a ~~*retail*~~ *client* must inform the *client*:
- ...
- (3) A *firm* within (1) must also, before entering into *securities financing transactions* in relation to *designated investments* held by it on behalf of a ~~*retail*~~ *client*, or before otherwise using such *designated investments* for its own account or the account of another *client*, in good time before the use of those *designated investments* provide the *client*, in a *durable medium*, with clear, full and accurate information on the obligations and responsibilities of the *firm* with respect to the use of those *designated investments*, including the terms for their restitution, and on the risks involved.
- (4) ~~A *firm* within (1) that holds *client designated investments* or *client money* for a *professional client* must provide that *client* with the information in paragraphs (1)(d) and (2)(a) and (b): [deleted]~~

~~[Note: articles 29(3), 30(1)(g) and 32 of the MiFID implementing Directive]~~

...

Information about costs and associated charges

- 6.1.9 R A *firm* must provide a ~~*retail*~~ *client* with information on costs and associated charges including, if applicable:

- (1) the total price to be paid by the *client* in connection with the *designated investment* or the *designated investment business* ~~or ancillary services~~, including all related fees, commissions, charges and expenses, and all taxes payable via the *firm* or, if an exact price cannot be indicated, the basis for the calculation of the total price so that the *client* can verify it. The commissions charged by the *firm* must be itemised separately in every case;

...

~~[Note: article 33 of the MiFID implementing Directive]~~

- 6.1.10 G The *rules* on inducements in *COBS 2.3* and *COBS 2.3A* may also require a *firm* to disclose information to a *client* in relation to benefits provided to the *firm*.

Timing of disclosure

- 6.1.11 R (1) A *firm* must provide a *client* with the information required by this section in good time before the provision of *designated investment business* ~~or ancillary services~~ unless otherwise provided by this *rule*.

- (2) A *firm* may instead provide that information immediately after starting to provide *designated investment business* ~~or ancillary services~~ if:

...

- (b) in any case where the *rule* on voice telephony communications (*COBS 5.1.12R*) does not otherwise apply, the *firm* complies with that *rule* in relation to the ~~retail~~ *client*, as if that *client* were a *consumer*.

~~[Note: article 29(2), 29(3) and 29(5) of the MiFID implementing Directive]~~

...

Medium of disclosure

- 6.1.13 R ...

~~[Note: article 29(4) of the MiFID implementing Directive]~~

Keeping the client up to date

- 6.1.14 R ...

~~[Note: article 29(6) of the MiFID implementing Directive]~~

Existing clients

- 6.1.15 G (1) A *firm* need not treat each of several transactions in respect of the

same type of *designated investment* as a new or different service and so does not need to comply with the disclosure *rules* in this chapter in relation to each transaction.

~~[Note: recital 50 to the MiFID implementing Directive]~~

...

Compensation information

- 6.1.16 R (1) ~~A firm carrying on MiFID business~~ must make available to a *client*, who has used or intends to use ~~those~~ the firm's services, information necessary for the identification of the *compensation scheme* or any other investor-compensation scheme of which the *firm* is a member (including, if relevant, membership through a *branch*) or any alternative arrangement provided for in accordance with the *Investor Compensation Directive*.

...

...

After COBS 6 (Information about the firm, its services and remuneration) insert the following new section. All the text is new and is not underlined.

**6.1-A Information about the firm, its services and remuneration (MiFID provisions)**

**6.1-A.1 Application**

[Note: ESMA has also issued guidelines under article 16(3) of the ESMA Regulation on cross-selling practices. See [LINK to follow]

Application

- 6.1-A.1.1 R (1) Subject to (2) and (3), this section applies to a *firm* in relation to its *MiFID, equivalent third country or optional exemption business*.
- (2) *COBS 6.1-A.2.12R* does not apply to a *firm* in respect of its *MiFID optional exemption business*.
- (3) *COBS 6.1-A.2.19R* applies to a *firm* in relation to its *designated investment business*.
- 6.1-A.1.2 G This section imposes requirements relating to disclosure of information to *clients* that are additional to the general requirements in *COBS 2.2* and *COBS 2.2A*.

- 6.1-A.1.3 R In relation to:
- (a) *MiFID optional exemption business*; and
  - (b) *the equivalent business of a third country investment firm*,
- provisions in this chapter marked “EU” apply as if they were *rules*.

## 6.1-A.2 Information about a firm and its services

- 6.1-A.2.1 EU 47(1) Investment firms shall provide clients or potential clients with the following general information, where relevant:
- (a) the name and address of the investment firm, and the contact details necessary to enable clients to communicate effectively with the firm;
  - (b) the languages in which the client may communicate with the investment firm, and receive documents and other information from the firm;
  - (c) the methods of communication to be used between the investment firm and the client including, where relevant, those for the sending and reception of orders;
  - (d) a statement of the fact that the investment firm is authorised and the name and contact address of the competent authority that has authorised it;
  - (e) where the investment firm is acting through a tied agent, a statement of this fact specifying the Member State in which that agent is registered;
  - (f) the nature, frequency and timing of the reports on the performance of the service to be provided by the investment firm to the client in accordance with Article 25(6) of Directive 2014/65/EU;
  - (g) where the investment firm holds client financial instruments or client funds, a summary description of the steps which it takes to ensure their protection, including summary details of any relevant investor compensation or deposit guarantee scheme which applies to the firm by virtue of its activities in a Member State;
  - (h) a description, which may be provided in summary form, of the conflicts of interest policy maintained by the firm in accordance with Article 34;
  - (i) at the request of the client, further details of that conflicts of interest policy in a durable medium or by means of a



website (where that does not constitute a durable medium) provided that the conditions set out Article 3(2) are satisfied.

The information listed in points (a) to (i) shall be provided in good time before the provision of investment services or ancillary services to clients or potential clients.

[Note: article 47(1) of the *MiFID Org Regulation*]

- 6.1-A.2.2 G Reference in *COBS* 6.1-A.2.1EU to “Article 25(6) of Directive 2014/65/EU” is to the requirements in *COBS* 16A.1.2R.
- 6.1-A.2.3 G A *firm* disclosing details of its authorisation should refer to the appropriate form of words set out in *GEN* 4 Annex 1R or *GEN* 4 Annex 1AR as appropriate.

Information about a firm’s portfolio management service

- 6.1-A.2.4 EU 47(2) When providing the service of portfolio management, investment firms shall establish an appropriate method of evaluation and comparison such as a meaningful benchmark, based on the investment objectives of the client and the types of financial instruments included in the client portfolio, so as to enable the client for whom the service is provided to assess the firm's performance.
- 47(3) Where investment firms propose to provide portfolio management services to a client or potential client, they shall provide the client, in addition to the information required under paragraph 1, with such of the following information as is applicable:
  - (a) information on the method and frequency of valuation of the financial instruments in the client portfolio;
  - (b) details of any delegation of the discretionary management of all or part of the financial instruments or funds in the client portfolio;
  - (c) a specification of any benchmark against which the performance of the client portfolio will be compared;
  - (d) the types of financial instrument that may be included in the client portfolio and types of transaction that may be carried out in such instruments, including any limits;
  - (e) the management objectives, the level of risk to be reflected in the manager's exercise of discretion, and any specific constraints on that discretion.

The information listed in points (a) to (e) shall be provided in good time before the provision of investment services or ancillary services to clients or potential clients.

[**Note:** articles 47(2) and (3) of the *MiFID Org Regulation*]

Information concerning safeguarding of financial instruments belonging to clients and client money

6.1-A.2.5	EU	<p>49(1) Investment firms holding financial instruments or funds belonging to clients shall provide those clients or potential clients with the information specified in paragraphs 2 to 7 where relevant.</p> <p>49(2) The investment firm shall inform the client or potential client where the financial instruments or funds of that client may be held by a third party on behalf of the investment firm and of the responsibility of the investment firm under the applicable national law for any acts or omissions of the third party and the consequences for the client of the insolvency of the third party.</p> <p>49(3) Where financial instruments of the client or potential client may, if permitted by national law, be held in an omnibus account by a third party, the investment firm shall inform the client of this fact and shall provide a prominent warning of the resulting risks.</p> <p>49(4) The investment firm shall inform the client or potential client where it is not possible under national law for client financial instruments held with a third party to be separately identifiable from the proprietary financial instruments of that third party or of the investment firm and shall provide a prominent warning of the resulting risks.</p> <p>49(5) The investment firm shall inform the client or potential client where accounts that contain financial instruments or funds belonging to that client or potential client are or will be subject to the law of a jurisdiction other than that of a Member State and shall indicate that the rights of the client or potential client relating to those financial instruments or funds may differ accordingly.</p> <p>49(6) An investment firm shall inform the client about the existence and the terms of any security interest or lien which the firm has or may have over the client's financial instruments or funds, or any right of set-off it holds in relation to those instruments or funds. Where applicable, it shall also inform the client of the fact that a depository may have a security interest or lien over, or right of set-off in relation to those</p>
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instruments or funds.

49(7) An investment firm, before entering into securities financing transactions in relation to financial instruments held by it on behalf of a client, or before otherwise using such financial instruments for its own account or the account of another client shall in good time before the use of those instruments provide the client, in a durable medium, with clear, full and accurate information on the obligations and responsibilities of the investment firm with respect to the use of those financial instruments, including the terms for their restitution, and on the risks involved.

[**Note:** article 49 of the *MiFID Org Regulation*]

- 6.1-A.2.6 G *Firms* subject to either or both the *custody rules* and the *client money rules* are reminded of the information requirements concerning *custody assets* and *client money* in CASS 9.3 (Prime brokerage agreement disclosure annex) and CASS 9.4 (Information to clients concerning custody assets and client money).

Information about costs and associated charges

- 6.1-A.2.7 R *COBS 2.2A.2R* requires a *firm* to provide a *client* with information about all costs and related charges. That information must include:
- (1) information relating to both *investment services* and *ancillary services*;
  - (2) where relevant, the cost of any *investment advice*;
  - (3) the cost of the *financial instrument* recommended or marketed to the *client*;
  - (4) information on how the *client* may pay; and
  - (5) details of any third party payments.

[**Note:** article 24(4)(c) of *MiFID*]

- 6.1-A.2.8 R
- (1) A *firm* must aggregate the information about costs and charges required by *COBS 2.2A.2R* and *COBS 6.1-A.2.7R*, where those costs and charges are not caused by the occurrence of underlying market risk. This is to allow the *client* to understand the overall cost, and the cumulative effect on the return, of the investment.
  - (2) A *firm* must provide the *client* with an itemised breakdown of the costs and charges information required by (1) and *COBS 6.1-A.2.7R* when requested by the *client*.
  - (3) The information must, where applicable, be provided to the *client* on a regular basis, and at least annually, during the life of the

investment.

[Note: article 24(4) of *MiFID*]

- 6.1-A.2.9 R (1) A *firm* must provide the information required by *COBS* 6.1-A.2.7R and *COBS* 6.1-A.2.8R in a comprehensible form in such a manner that the *client* is reasonably able to understand the nature and risks of the *investment service* and of the specific type of *financial instrument* that is being offered and, consequently, to take investment decisions on an informed basis.
- (2) That information may be provided in a standardised format.

[Note: article 24(5) of *MiFID*]

- 6.1-A.2.10 EU 50 (1) For the purposes of providing information to clients on all costs and charges pursuant to Article 24(4) of Directive 2014/65/EU, investment firms shall comply with the detailed requirements in paragraphs 2 to 10.
- Without prejudice to the obligations set out in Article 24(4) of Directive 2014/65/EU, investment firms providing investment services to professional clients shall have the right to agree to a limited application of the detailed requirements set out in this Article with these clients. Investment firms shall not be allowed to agree such limitations when the services of investment advice or portfolio management are provided or when, irrespective of the investment service provided, the financial instruments concerned embed a derivative.
- Without prejudice to the obligations set out in Article 24(4) of Directive 2014/65/EU, investment firms providing investment services to eligible counterparties shall have the right to agree to a limited application of the detailed requirements set out in this Article, except when, irrespective of the investment service provided, the financial instruments concerned embed a derivative and the eligible counterparty intends to offer them to its clients.
- (2) For ex-ante and ex-post disclosure of information on costs and charges to clients, investment firms shall aggregate the following:
- (a) all costs and associated charges charged by the investment firm or other parties where the client has been directed to such other parties, for the investment services(s) and/or ancillary services provided to the client; and
- (b) all costs and associated charges associated with the manufacturing and managing of the financial instruments.

Costs referred to in points (a) and (b) are listed in Annex II to this Regulation. For the purposes of point (a), third party payments received by investment firms in connection with the investment service provided to a client shall be itemised separately and the aggregated costs and charges shall be totalled and expressed both as a cash amount and as a percentage.

- (3) Where any part of the total costs and charges is to be paid in or represents an amount of foreign currency, investment firms shall provide an indication of the currency involved and the applicable currency conversion rates and costs. Investment firms shall also inform about the arrangements for payment or other performance.
- (4) In relation to the disclosure of product costs and charges that are not included in the UCITS KIID, the investment firms shall calculate and disclose these costs, for example, by liaising with UCITS management companies to obtain the relevant information.
- (5) The obligation to provide in good time a full ex-ante disclosure of information about the aggregated costs and charges related to the financial instrument and to the investment or ancillary service provided shall apply to investment firms in the following situations:
  - (a) where the investment firm recommends or markets financial instruments to clients; or
  - (b) where the investment firm providing any investment services is required to provide clients with a UCITS KIID or PRIIPs KID in relation to the relevant financial instruments, in accordance with relevant Union legislation.
- (6) Investment firms that do not recommend or market a financial instrument to the client or are not obliged to provide the client with a KID/KIID in accordance with relevant Union legislation shall inform their clients about all costs and charges relating to the investment and/or ancillary service provided.
- (7) Where more than one investment firm provides investment or ancillary services to the client, each investment firm shall provide information about the costs of the investment or ancillary services it provides. An investment firm that recommends or markets to its clients the services provided by another firm, shall aggregate the cost and charges of its services together with the cost and charges of the services provided by the other firm. An

investment firm shall take into account the costs and charges associated to the provision of other investment or ancillary services by other firms where it has directed the client to these other firms.

- (8) Where calculating costs and charges on an ex-ante basis, investment firms shall use actually incurred costs as a proxy for the expected costs and charges. Where actual costs are not available, the investment firm shall make reasonable estimations of these costs. Investment firms shall review ex-ante assumptions based on the ex-post experience and shall make adjustment to these assumptions, where necessary.
- (9) Investment firms shall provide annual ex-post information about all costs and charges related to both the financial instrument(s) and investment and ancillary service(s) where they have recommended or marketed the financial instrument(s) or where they have provided the client with the KID/KIID in relation to the financial instrument(s) and they have or have had an ongoing relationship with the client during the year. Such information shall be based on costs incurred and shall be provided on a personalised basis.

Investment firms may choose to provide such aggregated information on costs and charges of the investment services and the financial instruments together with any existing periodic reporting to clients.

- (10) Investment firms shall provide their clients with an illustration showing the cumulative effect of costs on return when providing investment services. Such an illustration shall be provided both on an ex-ante and ex-post basis. Investment firms shall ensure that the illustration meets the following requirements:
- (a) the illustration shows the effect of the overall costs and charges on the return of the investment;
  - (b) the illustration shows any anticipated spikes or fluctuations in the costs; and
  - (c) the illustration is accompanied by a description of the illustration.

[**Note:** article 50 of the *MiFID Org Regulation*]

- 6.1-A.2.11 G The *rules* on inducements in *COBS 2.3A* may also require a *firm* to disclose information to a *client* in relation to the benefits provided to a *firm*.

Information about costs and charges of different services or products

- 6.1-A.2.12 R (1) This *rule* applies to a *firm* that offers an *investment service* with another service or product or as part of a package or as a condition of the same agreement or package.
- (2) The *firm* must inform the *client* whether it is possible to buy the different components separately and must provide information on the costs and charges of each component.
- (3) If the agreement or package is offered to a *retail client*, the *firm* must:
- (a) inform that *retail client* if the risks resulting from the agreement or package are likely to be different from the risks associated with the components when taken separately; and
  - (b) provide that *retail client* with an adequate description of the different components of the agreement or package and the way in which its interaction modifies the risks.

[**Note:** article 24(11) of *MiFID*]

General disclosure requirements

- 6.1-A.2.13 EU 46(1) Investment firms shall, in good time before a client or potential client is bound by any agreement for the provision of investment services or ancillary services or before the provision of those services, whichever is the earlier to provide that client or potential client with the following information:
- (a) the terms of any such agreement;
  - (b) the information required by Article 47 relating to that agreement or to those investment or ancillary services.

[**Note:** article 46(1) of the *MiFID Org Regulation*]

Timing of disclosure

- 6.1-A.2.14 EU 46(2) Investment firms shall, in good time before the provision of investment services or ancillary services to clients or potential clients, to provide the information required under Articles 47 to 50.

[**Note:** article 46(2) of the *MiFID Org Regulation*]

- 6.1-A.2.15 G The following provisions of *COBS* reproduce the information requirements contained in Articles 47 to 50 of the *MiFID Org Regulation*: *COBS* 6.1-A.2.1EU, *COBS* 6.1-A.2.4EU, *COBS* 6.1-

A.2.5EU, COBS 6.1-A.2.10EU, and COBS 14.3A.5EU.

#### Medium of disclosure

- 6.1-A.2.16 EU 46(3) The information referred to in paragraphs 1 and 2 shall be provided in a durable medium or by means of a website (where it does not constitute a durable medium) provided that the conditions specified in Article 3(2) are satisfied.

[**Note:** article 46(3) of the *MiFID Org Regulation*]

#### Keeping the client up to date

- 6.1-A.2.17 EU 46(4) Investment firms shall notify a client in good time about any material change to the information provided under Articles 47 to 50 which is relevant to a service that the firm is providing to that client. That notification shall be given in a durable medium if the information to which it relates is given in a durable medium.

[**Note:** article 46(4) of the *MiFID Org Regulation*]

#### Existing clients

- 6.1-A.2.18 G (1) A *firm* need not treat each of several transactions in respect of the same type of *financial instrument* as a new or different service and so does not need to comply with the disclosure *rules* in this chapter in relation to each transaction.

[**Note:** recital 69 to the *MiFID Org Regulation*]

- (2) A *firm* should ensure that the *client* has received all relevant information in relation to a subsequent transaction, such as details of product charges that differ from those disclosed in respect of a previous transaction.

#### Compensation information

- 6.1-A.2.19 R (1) A *firm* must make available to a *client*, who has used or intends to use a *firm's* services, information necessary for the identification of the *compensation scheme* or any other investor-compensation scheme of which the *firm* is a member (including, if relevant, membership through a *branch*) or any alternative arrangement provided for in accordance with the *Investor Compensation Directive*.
- (2) The information under (1) must include the amount and scope of the cover offered by the compensation scheme and any rules laid down by the *EEA State* pursuant to article 2(3) of the *Investor Compensation Directive*.
- (3) A *firm* must provide, on the *client's* request, information concerning the conditions governing compensation and the



formalities which must be completed to obtain compensation.

- (4) The information provided for in this *rule* must be made available in a *durable medium* or via a website if the *website conditions* are satisfied in the official language or languages of the *EEA State*.

[**Note:** article 10(1) and (2) of the *Investor Compensation Directive*]

Record keeping: information about the firm and compensation information

- 6.1-A.2.20 G *Firms* are reminded of the general record-keeping requirements in SYSC 9.

## 6.1A Adviser charging and remuneration

...

Requirement to be paid through adviser charges

- 6.1A.4 R Except as specified in *COBS 6.1A.4AR*, *COBS 6.1A.4ABR*, *COBS 6.1A.4ACG* and *COBS 6.1A.4BR*, a *firm* must:
- (1) only be remunerated for the *personal recommendation* (and any other related services provided by the *firm*) by *adviser charges*; and
  - (2) not solicit or accept (and ensure that none of its *associates* solicits or accepts) any other commissions, remuneration or benefit of any kind in ~~relation to the *personal recommendation*~~ connection with the *firm*'s business of *advising on investments* or any other related service, regardless of whether it intends to refund the payments or pass the benefits on to the *retail client* other than reasonable minor non-monetary benefits which meet the requirements of:
    - (a) [*COBS 2.3A.15R*], in relation to the provision of *investment services*; or
    - (b) [*COBS 6.1A.5AR*], in relation to other business,  
regardless of whether it intends to refund the payments or pass the benefits on to the *retail client*; and
  - (3) not solicit or accept (and ensure that none of its *associates* solicits or accepts) *adviser charges* in relation to the *retail client's retail investment product* or *P2P agreement* which are paid out or advanced by another party over a materially different time period, or on a materially different basis, from that in or on which the *adviser charges* are recovered from the *retail client*.

...

6.1A.5 G ...

Minor non-monetary benefits6.1A.5A R An acceptable minor non-monetary benefit is one:

- (1) which is clearly disclosed prior to the provision of the relevant service to the *client*, which the *firm* may describe in a generic way;
- (2) which is capable of enhancing the quality of service provided to the *client*;
- (3) which is of a scale and nature that it could not be judged to impair the *firm's* compliance with its duty to act honestly, fairly and professionally in the best interests of the *client*;
- (4) which is reasonable, proportionate and of a scale that is unlikely to influence the *firm's* behaviour in any way that is detrimental to the interests of the relevant *client*; and
- (5) which consists of:
  - (a) information or documentation relating to a specific *retail investment product* or a service provided in the course of carrying on related *designated investment business*, that 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 a corporate *issuer* or potential *issuer* to promote a new issuance by the company, or where the third party *firm* is contractually engaged and paid by the *issuer* to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any *firms* wishing to receive it, or to the general public;
  - (c) participation in conferences, seminars and other training events on the benefits and features of a specific *retail investment product* or a service provided in the course of carrying on related *designated investment business*; and
  - (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 paragraph (c).

6.1A.5B G [COBS 2.3A.4R] sets out the conditions to be met if a fee, commission or non-monetary benefit is designed to enhance the quality of the service to a *client* in relation to *MiFID*, *equivalent third country* or *optional exemption*

*business*. For the purposes of [COBS 2.3A.15R(2)] and [COBS 6.1A.5AR(2)], those conditions are also likely to be relevant to *firms* considering whether a fee, commission or non-monetary benefit is capable of enhancing the quality of the service to a *client* in relation to the restriction in [COBS 6.1A.4R(2)].

[**Note:** articles 24(7) and (8) of *MiFID* refer to minor non-monetary benefits that are capable of enhancing the quality of service provided to the *client*]

...

**6.1B Retail investment product provider, operator of an electronic system in relation to lending, and platform service provider requirements relating to adviser charging and remuneration**

...

Requirement not to offer commissions

- 6.1B.5 R (1) Except as specified in COBS 6.1B.5AR, a *firm* must not offer or pay (and must ensure that none of its *associates* offers or pays) any ~~commissions~~ commission, remuneration or benefit of any kind to another *firm*, or to any other third party for the benefit of that *firm*, ~~in relation to a personal recommendation~~ connection with that *firm*'s business of advising on investments (or any related services), except those that facilitate the payment of *adviser charges* from a *retail client*'s investments in accordance with this section.
- (2) Paragraph (1) does not apply to minor non-monetary benefits which meet the requirements of:
- (a) [COBS 2.3A.15R], in connection with the provision of investment services; or
  - (b) [COBS 6.1A.5AR], in connection with other business.

6.1B.5-A G The guidance in [COBS 6.1A5BG] is also relevant for the purposes of [COBS 6.1B.5R(2)].

6.1B.5A R ...

...

Requirements on firms facilitating the payment of adviser charges

...

6.1B.11 G COBS 6.1B.9R(3) does not prevent a *firm*, if this is in the *retail client*'s best interests, from entering into an agreement with another *firm* which is providing a *personal recommendation* to a *retail client*, or with a *retail client* of such a *firm*, to provide it with *credit* separately in accordance with

the *rules* on providing credit and other benefits to *firms* that advise on *retail investment products* or *P2P agreements* (COBS 2.3.12E and COBS 2.3.12AG, [COBS 2.3A.23E] and [COBS 2.3A.24G]).

...

**6.1F Using a platform service for arranging and advising**

Client's best interests rule and using a platform service

...

- 6.1F.2 G When selecting and using a *platform service* for the purpose described in COBS 6.1F.1R, a *firm* should be mindful of its duty to comply with the *client's best interests rule* and the ~~rule~~ *rules* on inducements (COBS 2.3.1R, [COBS 2.3A.3R] and [COBS 2.3A.11R]).

COBS 6.2A (Describing advice services) is deleted in its entirety. The deleted text is not shown.

After the deleted COBS 6.2A insert the following new section COBS 6.2B. All the text is new and is not underlined.

**6.2B Describing advice services**

Application

- 6.2B.1 R (1) This section applies to a *firm* that provides:
- (a) *investment advice* in the course of *MiFID*, *equivalent third country* or *optional exemption business* to *clients* in relation to *financial instruments* or *structured deposits*; or
  - (b) *investment advice* to *retail clients* in the *United Kingdom* in relation to *financial instruments*, *structured deposits* or other *retail investment products*; or
  - (c) *basic advice* to *retail clients* in the *United Kingdom*.
- 6.2B.2 R (1) This section does not apply to a *firm* when it makes a *personal recommendation* or provides *basic advice* to an employee, if that recommendation or advice is provided under the terms of an agreement between the *firm* and that employee's employer which is subject to the rules on *consultancy charges* (COBS 6.1C).
- (2) This section does not apply to a *firm* when it makes a *personal recommendation* to a *retail client* in relation to a *Holloway sickness policy*, provided that the *Holloway policy special application conditions* are met.

- 6.2B.3 G *P2P agreements* are neither *financial instruments* nor *retail investment products*. This section does not apply to a *firm* when it is *advising on P2P agreements*.
- 6.2B.4 G (1) This section applies in accordance with the territorial scope of the *general application rule* as modified in *COBS 1 Annex 1*.
- (2) But the effect of *COBS 6.2B.1R(1)* and *COBS 6.2B.6R* to *COBS 6.2B.9R* is that:
- (a) this section does not apply to a *firm* that provides *investment advice* to a *retail client* in relation to a *retail investment product* that is not a *financial instrument* if the *retail client* is outside the *United Kingdom*; and
- (b) a *firm* that carries on *MiFID* or *equivalent third country business* with a *retail client* outside the *United Kingdom* need only have regard to *financial instruments* and *structured deposits* (and not other *retail investment products*) in conducting its assessment for the purposes of *COBS 6.2B.11R*.

#### Introduction

- 6.2B.5 G This section transposes provisions in *MiFID* on describing advice services relating to *financial instruments* and *structured deposits* for all *clients* and reproduces a number of provisions of the directly applicable *MiFID Org Regulation* as explained in *COBS 1.2*. The requirements apply in relation to *MiFID*, *equivalent third country* or *optional exemption business*. The requirements are extended to apply to other *investment advice* and cover other *retail investment products* when the *client* is a *retail client* in the *United Kingdom*.

#### Interpretation of rules and guidance: relevant products

- 6.2B.6 R In this section a “relevant product” is:
- (1) where the *client* is a *retail client* in the *United Kingdom*, a *financial instrument*, *structured deposit* or other *retail investment product*;
- (2) otherwise, a *financial instrument* or *structured deposit*.

[**Note:** article 1(4) of *MiFID*]

#### Interpretation of EU provisions: MiFID business

- 6.2B.7 R A *firm* must treat obligations in relation to *financial instruments* as extending to other *retail investment products* when complying with the provisions in this section marked “EU” in the course of *MiFID business* with a *retail client* in the *United Kingdom*.

- 6.2B.8 G References to *financial instruments* include *structured deposits* (but not other *retail investment products*) when a *firm* is complying with the provisions in this section marked “EU” in the course of *MiFID business* with a *retail client* outside the *United Kingdom* or with a *professional client*.

[Note: article 1(2) of the *MiFID Org Regulation*]

Interpretation of EU provisions: non-MiFID business

- 6.2B.9 R In relation to business that is not *MiFID business*, a *firm* must comply with provisions in this section marked “EU” as if they were *rules* but:
- (1) reading references to *financial instruments* as including *structured deposits* and (if the *client* is a *retail client* in the *United Kingdom*) other *retail investment products*;
  - (2) (for business that is not *equivalent business of a third country investment firm* or *MiFID optional exemption business*) the *firm* need not comply with the following provisions of the *MiFID Org Regulation*:
    - (a) the requirement in paragraph 2 of article 52(1) of the *MiFID Org Regulation* (reproduced in *COBS 6.2B.30EU*) not to give undue prominence to their *independent advice* services;
    - (b) the requirement in article 52(4) of the *MiFID Org Regulation* (reproduced in *COBS 6.2B.33EU*) to distinguish the range of *financial instruments* issued or provided by entities not being closely linked with the *firm*; and
    - (c) the requirement in article 53(3)(c) of the *MiFID Org Regulation* (reproduced in *COBS 6.2B.28EU*) that a *firm* does not allow a natural person to provide both *independent advice* and *restricted advice*.

Interpretation: non-independent advice and restricted advice

- 6.2B.10 G This section refers to both “restricted advice” and “non-independent advice”. These terms have the same meaning.

Firms holding themselves out as independent

- 6.2B.11 R If a *firm* informs a *client* that it provides *independent advice*, that *firm* must assess a sufficient range of relevant products available on the market which must:
- (1) be sufficiently diverse with regard to their:
    - (a) type; and
    - (b) issuers or product providers,

to ensure that the *client's* investment objectives can be suitably met; and

- (2) not be limited to relevant products issued or provided by:
  - (a) the *firm* itself or by entities having close links with the *firm*; or
  - (b) other entities with which the *firm* has such close legal or economic relationships, including contractual relationships, as to present a risk of impairing the independent basis of the advice provided.

[Note: article 24(7)(a) of *MiFID*]

6.2B.12 R *COBS* 6.2B.11R does not apply to *group personal pension schemes* if a *firm* discloses information to a *client* in accordance with the rule on *group personal pension schemes* (*COBS* 6.1C.20AR).

6.2B.13 G The combined effect of *COBS* 6.2B.6R and *COBS* 6.2B.11R is that the assessment undertaken by a *firm* for the purpose of *COBS* 6.2B.11R must:

- (1) where the *client* is a *retail client* in the *United Kingdom*, include a sufficient range of *financial instruments*, *structured deposits* and other *retail investment products*; or otherwise
- (2) include a sufficient range of *financial instruments* and *structured deposits*,

which in each case must meet the requirements as to diversity and scope in *COBS* 6.2B.11R(1) and (2) respectively.

#### Requirements for firms providing focused independent advice

6.2B.14 G A *firm* that holds itself out as providing *independent advice* may provide broad and general advice or specialist and specific advice.

[Note: recital 71 to the *MiFID Org Regulation*]

6.2B.15 EU 53(2) An investment firm that provides investment advice on an independent basis and that focuses on certain categories or a specified range of financial instruments shall comply with the following requirements:

- (a) the firm shall market itself in a way that is intended only to attract clients with a preference for those categories or range of financial instruments;
- (b) the firm shall require clients to indicate that they are only interested in investing in the specified category or range of financial instruments; and

- (c) prior to the provision of the service, the firm shall ensure that its service is appropriate for each new client on the basis that its business model matches the client's needs and objectives, and the range of financial instruments that are suitable for the client. Where this is not the case the firm shall not provide such a service to the client.

[**Note:** article 53(2) of the *MiFID Org Regulation*]

- 6.2B.16 G (1) *COBS* 6.2B.15EU means that a *firm* providing *independent advice* need not provide advice on all relevant products. A *firm* may market itself as, for example, an independent stockbroker that provides *independent advice* on *shares* only. A *firm* might alternatively market itself on the basis of providing *independent advice* on a particular product market such as ethical and socially responsible investments. The requirements in *COBS* 6.2B.15EU apply to ensure that *clients* of a *firm* that provides *independent advice* on a focused basis properly understand the nature of the advice that they will receive and that the service is appropriate.
- (2) A *firm* that provides *independent advice* in respect of a relatively narrow market should not hold itself out as acting independently in a broader sense. A *firm* which specialises in providing advice in respect of a particular market might include reference to the provision of independent investment advice in its name. However, it would need to be clear in any marketing materials, and when describing its service, that it only provides *independent advice* in respect of that particular product market.

Sufficient range

- 6.2B.17 G The extent of the assessment which a *firm* is required to undertake in order to meet the requirement to assess a sufficient range of relevant products will depend on:
- (1) the nature of the *independent advice* service provided by the *firm* (general or focused) for the purposes of *COBS* 6.2B.15EU;
- (2) the investment objectives of the *client* (*COBS* 6.2B.11R(1)); and
- (3) the *firm*'s close links and relationships with product providers and issuers (*COBS* 6.2B.11R(2)).

- 6.2B.18 EU 53(1) Investment firms providing investment advice on an independent basis shall define and implement a selection process to assess and compare a sufficient range of financial instruments available on the market in accordance with Article 24(7)(a) of Directive 2014/65/EU. The selection process shall include the following elements:
- (a) the number and variety of financial instruments considered



is proportionate to the scope of investment advice services offered by the independent investment adviser;

- (b) the number and variety of financial instruments considered is adequately representative of financial instruments available on the market;
- (c) the quantity of financial instruments issued by the investment firm itself or by entities closely linked to the investment firm itself is proportionate to the total amount of financial instruments considered; and
- (d) the criteria for selecting the various financial instruments shall include all relevant aspects such as risks, costs and complexity as well as the characteristics of the investment firm's clients, and shall ensure that the selection of the instruments that may be recommended is not biased.

[**Note:** article 53(1) of the *MiFID Org Regulation*]

- 6.2B.19 G (1) *COBS 6.2B.11R* does not require a *firm* providing *independent advice* to assess every relevant product available on the market before making a *personal recommendation*.

[**Note:** recital 73 to *MiFID*]

- (2) Notwithstanding (1), since the assessment conducted by the *firm* must be such as to ensure the *client's* investment objectives can be suitably met, a *firm* providing *independent advice* should be in a position to advise on all types of relevant product within the scope of the market (for the purposes of *COBS 6.2B.15EU*) on which it provides advice. When the *client* is a *retail client* in the *United Kingdom*, this means being in a position to advise on all types of *financial instrument*, *structured deposit* and other *retail investment products*.
- (3) For example, a *firm* providing *independent advice* on *personal pension schemes* should be in a position to consider all *personal pension schemes*. What will constitute a sufficient range of *personal pension schemes* to be considered before providing a *client* with a *personal recommendation* will, however, depend upon the investment objectives of that *client*.
- (4) A *firm* not specialising in a particular market would generally be expected to be in a position to consider all relevant product types which would be capable of meeting the investment objectives of its *clients*.
- (5) If a *firm* that provides focused *independent advice* is not able to recommend a *financial instrument* that would meet the investment objectives of a *client*, the *firm* should not provide that *client* with a *personal recommendation*. For example, if a *firm* providing

*independent advice* on shares considered that a *client's* investment objectives would be better met by way of investment in an accumulation product, it should not provide that *client* with a *personal recommendation*.

Guidance on the independence standard

- 6.2B.20 G A *personal recommendation* on a relevant product that invests in a number of underlying relevant products would not of itself enable the *firm* providing the *personal recommendation* to satisfy the requirement to have considered a sufficient range of relevant products which are sufficiently diverse (COBS 6.2B.11R), even if the relevant product invests in a wide range of underlying *investments*.
- 6.2B.21 G The effect of COBS 6.2B.11R(2) is that a *firm* which is subject to any form of agreement with an issuer or provider of relevant products that confines that *firm* to providing advice on relevant products issued or provided by that other *person* only will not be in a position to provide *independent advice*.
- 6.2B.22 G The fact that a *firm* is owned by, or owns, in whole or in part, the issuer or provider of relevant products does not prevent that *firm* from providing *independent advice*, provided that the *firm's* assessment of relevant products is:
- (1) not limited to relevant products issued or provided by that related issuer or provider (COBS 6.2B.11R(2));
  - (2) proportionate; and
  - (3) not biased (COBS 6.2B.18EU).
- 6.2B.23 G In providing *independent advice* to a *retail client* in the *United Kingdom* a *firm* should consider financial products other than relevant products which are capable of meeting the investment needs and objectives of that *retail client*, examples of which could include national savings and investments (ns&i) products and *cash deposit ISAs*.

Use of platforms

- 6.2B.24 R A *firm* which:
- (1) holds itself out to a *retail client* in the *United Kingdom* as acting independently; and
  - (2) relies upon a single *platform service* to facilitate the majority of its *personal recommendations*,
- must ensure that, as appropriate, the selection of relevant products made available by the *platform service provider* is such as to enable the *firm* to satisfy the requirements of COBS 6.2B.11R.

## Use of panels

- 6.2B.25 G A *firm* providing *independent advice* may satisfy the requirement to assess a sufficient range of relevant products which are sufficiently diverse (COBS 6.2B.11R) by using ‘panels’. Such a *firm* would need to ensure that any panel is sufficiently broad in its composition to enable the *firm* to make *personal recommendations* based on an assessment of a sufficient range of relevant products available on the market which are sufficiently diverse. The *firm* would need to review the panel regularly and ensure that the *client’s* investment objectives can be suitably met.
- 6.2B.26 G When using a panel a *firm* may exclude a certain type or class of relevant product from the panel if, after review, there is a valid reason, consistent with this section and the *client’s best interests rule*, for doing so.
- 6.2B.27 G If a *firm* providing *independent advice* chooses to engage a third party to conduct an assessment of the relevant products available on the market, the *firm* remains responsible for complying with the requirements of COBS 6.2B.11R to ensure that its advice is based on an assessment of a sufficient range of relevant products which are sufficiently diverse as to ensure that the *client’s* investment objectives can be suitably met.

## Requirements for firms providing both independent and restricted advice

- 6.2B.28 EU 53(3) An investment firm offering investment advice on both an independent basis and on a non-independent basis shall comply with the following obligations:
- (a) in good time before the provision of its services, the investment firm has informed its clients, in a durable medium, whether the advice will be independent or non-independent in accordance with Article 24(4)(a) of Directive 2014/65/EU and the relevant implementing measures;
  - (b) the investment firm has presented itself as independent for its business as a whole but has only done so with respect to the services for which it provides investment advice on an independent basis; and
  - (c) the investment firms has adequate organisational requirements and controls in place to ensure that both types of advice services and advisers are clearly separated from each other and that clients are not likely to be confused about the type of advice that they are receiving and are given the type of advice that is appropriate for them. The investment firm shall not allow a natural person to provide both independent and non-independent advice.

[Note: article 53(3) of the *MiFID Org Regulation*]

- 6.2B.29 G A *firm* that offers an unlimited range of *regulated mortgage contracts*, or

gives advice in relation to *contracts of insurance* on the basis of a fair analysis, but offers *restricted advice* on relevant products should not hold itself out as acting independently for its business as a whole, for example by holding itself out as an independent financial adviser. However, it may disclose that it offers an unlimited range of *regulated mortgage contracts* or gives advice in relation to *contracts of insurance* on the basis of a fair analysis provided it makes clear in accordance with the *fair, clear and not misleading rule (COBS 4.2.1R)* that it provides *restricted advice* on relevant products.

6.2B.30	EU	52(1) Where advice is offered or provided to the same client on both an independent and non-independent basis, investment firms shall explain the scope of both services to allow investors to understand the differences between them and not present itself as an independent investment adviser for the overall activity. Firms shall not give undue prominence to their independent investment advice services over non-independent investment services in their communications with clients.
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[**Note:** article 52(1) of the *MiFID Org Regulation*]

Disclosing the nature of advice provided

6.2B.31	R	<p>(1) A <i>firm</i> must disclose to a <i>client</i>, in good time before the provision of <i>investment advice</i> or <i>basic advice</i>:</p> <ul style="list-style-type: none"> <li>(a) whether its advice will be: <ul style="list-style-type: none"> <li>(i) <i>independent advice</i>; or</li> <li>(ii) <i>restricted advice</i>;</li> </ul> </li> <li>(b) whether the advice will be based on a broad or more restricted analysis of different types of relevant products; and</li> <li>(c) where the advice will be <i>restricted advice</i>, whether the range will be limited to relevant products issued or provided by entities having close links with the <i>firm</i> or any other legal or economic relationships, such as contractual relationships, so as to present a risk of impairing the independent basis of the advice provided.</li> </ul>
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[**Note:** article 24(4)(a)(i) and (ii) of *MiFID*]

(2) A *firm* must include the term “independent advice” or “restricted advice” or both, as relevant, in the disclosure.

6.2B.32	EU	52(1) Investment firms shall explain in a clear and concise way whether and why investment advice qualifies as independent or non-independent and the type and nature of the restrictions that apply, including, when providing investment advice on an independent
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basis, the prohibition to receive and retain inducements.

[**Note:** article 52(1) of the *MiFID Org Regulation*]

- 6.2B.33 EU 52(2) Investment firms providing investment advice, on an independent or non-independent basis, shall explain to the client the range of financial instruments that may be recommended, including its relationship with the issuers or providers of the instruments.
- 52(3) Investment firms shall provide a description of the types of financial instruments considered, the range of financial instruments and providers analysed per each type of instrument according to the scope of the service, and, when providing independent advice, how the service provided satisfies the conditions for the provision of investment advice on an independent basis and the factors taken into consideration in the selection process used by the investment firm to recommend financial instruments, such as risks, costs and complexity of the financial instruments.
- 52(4) When the range of financial instruments assessed by the investment firm providing investment advice on an independent basis includes the investment firm's own financial instruments or those issued or provided by entities having close links or any other close legal or economic relationship with the investment firm as well as other issuers or providers which are not linked or related, the investment firm shall distinguish, for each type of financial instrument, the range of the financial instruments issued or provided by entities not having any links with the investment firm.

[**Note:** article 52(2), (3) and (4) of the *MiFID Org Regulation*]

Medium of disclosure

- 6.2B.34 G A *firm* should provide the disclosure information required by the *rule* on describing the breadth of a *firm's* advice service (*COBS* 6.2B.31R) in a *durable medium* or through a website (if it does not constitute a *durable medium*) provided the *website conditions* are satisfied.

Additional oral disclosure for firms providing restricted advice

- 6.2B.35 R If a *firm* provides *restricted advice* and engages in spoken interaction with the *retail client*, in addition to the disclosure required by *COBS* 6.2B.31R, a *firm* must disclose orally in good time before the provision of its *investment advice* that it provides *restricted advice* and the nature of that restriction.

- 6.2B.36 G Examples of statements which would comply with *COBS* 6.2B.35R include:

- (1) "I am a [Firm X] adviser offering restricted advice, which means that my advice is restricted to advice on [Firm X]"

[products/stakeholder products] only”; or

- (2) “I am a [Firm X] adviser offering restricted advice, which means that my advice is restricted to advice on [products/stakeholder products] from a limited number of companies that [Firm X] has selected”.

Record keeping

- 6.2B.37 G *Firms* are reminded of the general record keeping requirements in SYSC 3.2 and SYSC 9. A *firm* should keep appropriate records of the disclosures required by this section.

Systems and controls

- 6.2B.38 G (1) *Firms* are reminded of the systems and controls requirements in SYSC.
- (2) A *firm* providing *restricted advice* should take reasonable care to establish and maintain appropriate systems and controls to ensure that if there is no relevant product in the *firm's* range of products which meets the investment needs and objectives of the *client*, no *personal recommendation* should be made.
- (3) A *firm* specialising in a particular market should take reasonable care to establish and maintain appropriate systems and controls to ensure that it does not make a *personal recommendation* if there is a relevant product outside the market on which it provides *investment advice* which would meet the investment needs and objectives of the *client*.

...

**6.4 Disclosure of charges, remuneration and commission**

...

Guidance on disclosure requirements for packaged products -

...

- 6.4.9 G The *rules* in this section build on the disclosure of fees, ~~commissions~~ commission and non-monetary benefits made under the ~~rule~~ rules on inducements (*COBS* 2.3.1R, [*COBS* 2.3A.3R] and [*COBS* 2.3A.11R]).

...

**8 Client agreements (non-MiFID provisions)**

## 8.1 Client agreements: non-MiFID designated investment business

### Providing a client agreement Application

- 8.1.1 R (1) This chapter applies to a *firm* in relation to *designated investment business* carried on for:
- (a) a *retail client*; and
  - (b) ~~in relation to *MiFID* or equivalent third country business, a professional client.~~
- (2) ~~If expressly provided, this chapter also applies to a *firm* in relation to other *ancillary services* carried on for a *client*, but only in relation to its *MiFID* or equivalent third country business. [deleted]~~
- (3) But this chapter does not apply to:
- (a) a *firm* in relation to its *MiFID*, equivalent third country or optional exemption business; or
  - (b) a *firm* to the extent that it is *effecting contracts of insurance* in relation to a *life policy* issued or to be issued by the *firm* as principal.

### Providing a client agreement

- 8.1.2 R ...

~~[Note: article 39 of the *MiFID* implementing Directive]~~

- 8.1.3 R (1) A *firm* must, in good time before a *retail client* is bound by any agreement relating to *designated investment business* ~~or *ancillary services*~~ or before the provision of those services, whichever is the earlier, provide that *client* with:
- (a) the terms of any such agreement; and
  - (b) the information about the *firm* and its services relating to that agreement or to those services required by *COBS* 6.1.4R, including information on communications, conflicts of interest and authorised status.

...

- (4) ...

~~[Note: article 29(1), (4), (5) and (6) of the *MiFID* implementing Directive]~~

### Record keeping: client agreements

- 8.1.4 R (1) A *firm* must establish a record that includes the document or

documents agreed between it and a *client* which set out the rights and obligations of the parties, and the other terms on which it will provide services to the *client*.

- (2) The record must be maintained for ~~at least whichever is the longer of:~~
- (a) ~~5 years; or [deleted]~~
  - (b) ~~unless (c) applies, at least the duration of the relationship with the *client*; or~~
  - (c) in the case of a record relating to a *pension transfer, pension conversion, pension opt-out or FSAVC*, indefinitely.

~~[Note: article 19(7) of *MiFID* and article 51(1) of the *MiFID implementing Directive*. See article 51(3) of the *MiFID implementing Directive*]~~

8.1.5 R ...

~~[Note: article 19(7) of *MiFID* and article 39 of the *MiFID implementing Directive*]~~

8.1.6 G When considering its approach to client agreements, a *firm* should be aware of other obligations in the *Handbook* which may be relevant. These include the *fair, clear and not misleading rule* ~~and~~ the *rules* on disclosure of information to a *client* before providing services, ~~and~~ the *rules* on distance communications (principally in *COBS* 2.2, 5, 6 and 13) and the provisions on record keeping (principally in *SYSC* 9).

After COBS 8 (Client agreements: non-MiFID provisions) insert the following new section [COBS 8A Client agreements (MiFID provisions)]. All the text is new and is not underlined.

## **8A Client agreements (MiFID provisions)**

### **8A.1 Client agreements (MiFID, equivalent third country or optional exemption business)**

Application and purpose provisions

8A.1.1 R This chapter applies to a *firm* in relation to its *MiFID, equivalent third country or optional exemption business*.

- 8A.1.2 R
- (1) Subject to (2), provisions in this chapter marked “EU” apply to *MiFID optional exemption firms* as if they were *rules*.
  - (2) Provisions marked “EU” which derive from recitals to *MiFID* or the *MiFID Org Regulation* apply to all *firms* as *guidance*.

8A.1.3 EU In order to provide legal certainty and enable clients to better understand the



nature of the services provided, investment firms that provide investment or ancillary services to clients should enter into a written basic agreement with the client, setting out the essential rights and obligations of the firm and the client.

[**Note:** recital 90 to the *MiFID Org Regulation*]

#### Providing a client agreement: retail and professional clients

- 8A.1.4 EU Investment firms providing any investment service or the ancillary service referred to in Section B(1) of Annex I to Directive 2014/65/EC to a client after the date of application of this Regulation shall enter into a written basic agreement with the client, in paper or another durable medium, with the client setting out the essential rights and obligations of the firm and the client. Investment firms providing investment advice shall comply with this obligation only where a periodic assessment of the suitability of the financial instruments or services recommended is performed.

The written agreement shall set out the essential rights and obligations of the parties, and shall include the following:

- (a) a description of the services, and where relevant the nature and extent of the investment advice, to be provided;
- (b) in case of portfolio management services, the types of financial instruments that may be purchased and sold and the types of transactions that may be undertaken on behalf of the client, as well as any instruments or transactions prohibited; and
- (c) a description of the main features of any services referred to in Section B(1) of Annex I to Directive 2014/65/EC to be provided, including where applicable the role of the firm with respect to corporate actions relating to client instruments and the terms on which securities financing transactions involving client securities will generate a return for the client.

[**Note:** article 58 of the *MiFID Org Regulation*]

#### General requirement for information to clients

- 8A.1.5 EU Investment firms shall, in good time before a client or potential client is bound by any agreement for the provision of investment services or ancillary services or before the provision of those services, whichever is the earlier to provide that client or potential client with the following information:

- (a) the terms of any such agreement;
- (b) the information required by Article 47 relating to that agreement or to those investment or ancillary services.

[**Note:** article 46(1) of the *MiFID Org Regulation*]

8A.1.6 EU Investment firms shall, in good time before the provision of investment services or ancillary services to clients or potential clients, to provide the information required under Articles 47 to 50.

[Note: article 46(2) of the *MiFID Org Regulation*]

8A.1.7 EU The information referred to in paragraphs 1 and 2 shall be provided in a durable medium or by means of a website (where it does not constitute a durable medium) provided that the conditions specified in Article 3(2) are satisfied.

[Note: article 46(3) of the *MiFID Org Regulation*]

#### Avoiding duplicate information

- 8A.1.8 G (1) Articles 47 to 50 of the *MiFID Org Regulation* require a *firm* to provide a *client* with information about:
- (a) the *firm* and its services for *clients* and potential *clients* (including information on communications, conflicts of interest and authorised status);
  - (b) *financial instruments*;
  - (c) safeguarding of *client financial instruments* or *client* funds; and
  - (d) costs and associated charges.
- (2) Provided the information referred to in (1) is communicated to a *client* in good time before the provision of the service, a *firm* does not need to provide it either separately or by incorporating it in a *client* agreement.
- (3) The requirements for *firms* to provide *clients* with the information referred to in (1) are set out at *COBS 6.1-A*.

[Note: recital 84 to *MiFID*]

#### Record keeping: client agreements

8A.1.9 R A *firm* must establish a record that includes the document or documents agreed between it and a *client* which set out the rights and obligations of the parties, and the other terms on which it will provide services to the *client*.

[Note: article 25(5) of *MiFID*]

8A.1.10 EU Records which set out the respective rights and obligations of the investment firm and the client under an agreement to provide services, or the terms on which the firm provides services to the client, shall be retained for at least the duration of the relationship with the client.

[**Note:** article 73 of the *MiFID Org Regulation*]

- 8A.1.11 R For the purposes of this chapter, a *firm* may incorporate the rights and duties of the parties into an agreement by referring to other documents or legal texts.

[**Note:** article 25(5) of *MiFID*]

- 8A.1.12 G When considering its approach to *client* agreements, a *firm* should be aware of other obligations in the *Handbook* which may be relevant. These include the *fair, clear and not misleading rule*, the *rules* on disclosure of information to a *client* before providing services (principally in *COBS 2.2A*, 6.1-A and 13) and the provisions on record keeping (principally in *SYSC 9*).

## 9 Suitability (including basic advice) (non-MiFID provisions)

### 9.1 Application and purpose provisions

~~**Note:** ESMA has also issued guidelines under article 16(3) of the ESMA Regulation on certain aspects of the MiFID suitability requirements. See [http://www.esma.europa.eu/content/Guidelines\\_certain\\_aspects\\_MiFID\\_suitability\\_requirements](http://www.esma.europa.eu/content/Guidelines_certain_aspects_MiFID_suitability_requirements) [https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-387\\_en.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-387_en.pdf). [deleted]~~

Making personal recommendations Application

- 9.1.1 R This chapter applies to a *firm* which:
- (a) makes a *personal recommendation to a retail client* in relation to a *designated investment*; or
  - (b) *manages investments of a retail client*;
  - (c) *manages the assets of an occupational pension scheme, stakeholder pension scheme or personal pension scheme, other than in relation to its MiFID, equivalent third country or optional exemption business.*

- 9.1.1A G *COBS 9A contains suitability requirements which apply in respect of a firm's MiFID, equivalent third country or optional exemption business involving the provision of investment advice or portfolio management.*

...

Managing investments P2P agreements

- 9.1.3 R ~~This chapter applies to a *firm* which *manages investments*. [deleted]~~

...

~~Business which is not MiFID or equivalent third country business~~

9.1.4 R ~~In respect of the business of a firm which is not *MiFID or equivalent third country business*, this chapter only applies if:~~

~~(1) the client is a retail client; or~~

~~(2) the firm is managing the assets of an *occupational pension scheme, stakeholder pension scheme or personal pension scheme*. [deleted]~~

Life policies for professional clients

9.1.5 R If the firm makes a *personal recommendation* to a *professional client* to take out a *life policy*, this chapter applies, but only those *rules* which implement the requirements of the *Insurance Mediation Directive*.

...

## 9.2 Assessing suitability

Assessing suitability: the obligations

9.2.1 R ...

~~[Note: article 19(4) of *MiFID*, article 12(2) of the *Insurance Mediation Directive*]~~

9.2.2 R ...

~~[Note: articles 35(1), (3) and (4) of the *MiFID implementing Directive*]~~

9.2.3 R ...

~~[Note: article 37(1) of the *MiFID implementing Directive*]~~

9.2.4 R ...

~~[Note: article 37(2) of the *MiFID implementing Directive*]~~

Reliance on information

9.2.5 R ...

~~[Note: article 37(3) of the *MiFID implementing Directive*]~~

Insufficient information

9.2.6 R ...

~~[Note: article 35(5) of the *MiFID implementing Directive*]~~

- 9.2.7 G Although a *firm* may not be permitted to make a *personal recommendation* or take a decision to trade because it does not have the necessary information, its *client* may still ask the *firm* to provide another service such as, for example, to arrange a deal or to deal as agent for the *client*. If this happens, the *firm* should ensure that it receives written confirmation of the instructions. The *firm* should also bear in mind the *client's best interests rule* and any obligation it may have under the *rules* relating to appropriateness when providing the different service (see *COBS 10*, (appropriateness (for non-advised services and COBS 10A (appropriateness (for non-advised services in relation to MiFID, equivalent third country or optional exemption business)))).

~~Professional clients (MiFID and equivalent third country business)~~

- 9.2.8 R ~~(1) If a *firm* makes a *personal recommendation* or *manages investments* for a *professional client* in the course of *MiFID* or *equivalent third country business*, it is entitled to assume that, in relation to the products, transactions and services for which the *professional client* is so classified, the *client* has the necessary level of experience and knowledge for the purposes of *COBS 9.2.2R (1)(e)*.~~
- ~~(2) If the service consists of making a *personal recommendation* to a *per se professional client*, the *firm* is entitled to assume that the *client* is able financially to bear any related investment risks consistent with his investment objectives for the purposes of *COBS 9.2.2R (1)(b)*.  
[deleted]~~

~~[Note: article 35(2) of the *MiFID implementing Directive*]~~

...

### 9.3 Guidance on assessing suitability

- 9.3.1 G ...

~~[Note: recital 57 to the *MiFID implementing Directive*] [deleted]~~

Churning and switching

- 9.3.2 G ...

~~[Note: recital 57 to the *MiFID implementing Directive*] [deleted]~~

...

### 9.4 Suitability reports

Providing a suitability report

- 9.4.1 R ...

~~[Note: article 19(8) of MiFID]~~

...

## 9.5 Record keeping and retention periods for suitability records

...

9.5.2 R A *firm* must retain its records relating to suitability for a minimum of the following periods:

...

(2) if relating to a *life policy, personal pension scheme or stakeholder pension scheme*, five years; and

(3) ~~if relating to *MiFID or equivalent third country business*~~, five years; ~~and~~ [deleted]

...

9.5.3 R A *firm* need not retain its records relating to suitability if

~~(1) the *client* does not proceed with the recommendation; and~~

~~(2) they do not relate to *MiFID or equivalent third country business*.~~

...

After COBS 9 insert the following new chapter COBS 9A Suitability (MiFID, equivalent third country and optional exemption business). The text is not underlined.

### 9A.1 Suitability (MiFID, equivalent third country or optional exemption business)

Application and purpose

**Note:** ESMA has also issued guidelines under article 16(3) of the ESMA Regulation on certain aspects of the MiFID suitability requirements. See [https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-387\\_en.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-387_en.pdf).

Application

9A.1.1 R This chapter applies to a *firm* which provides *investment advice or portfolio management* in the course of *MiFID, equivalent third country or optional exemption business*.

Effect of provisions marked “EU” for third country investment firms and MiFID optional exemption firms

- 9A.1.2 R Provisions in this chapter marked “EU” apply in relation to *MiFID optional exemption business* as if they were *rules*.
- 9A.1.3 G The effect of *GEN 2.2.22AR* is that provisions in this chapter marked “EU” also apply in relation to the *equivalent business of a third country investment firm* as if they were *rules*.

## 9A.2 Assessing suitability

Assessing suitability: the obligations

- 9A.2.1 R When providing *investment advice* or *portfolio management* a firm must:
- (1) obtain the necessary information regarding the *client's*:
    - (a) knowledge and experience in the investment field relevant to the specific type of *financial instrument* or service;
    - (b) financial situation including his ability to bear losses; and
    - (c) investment objectives including his risk tolerance,
 so as to comply with (2).
  - (2) recommend *investment services* and *financial instruments*, or take the decision to trade, which is suitable for the *client* and, in particular, in accordance with the client’s risk tolerance and ability to bear losses.

[**Note:** first paragraph of Article 25(2) of *MiFID*]

- 9A.2.2 G *Firms* should undertake a suitability assessment not only when making a *personal recommendation* to buy a *financial instrument* but for all decisions whether to trade, including making any *personal recommendations* about whether or not to buy, hold or sell an investment.

[**Note:** recital 87 to the *MiFID Org Regulation*]

- 9A.2.3 G Where a *firm* providing a *portfolio management* service makes a recommendation or request, or provides advice, to a *client* to the effect that the *client* should give or alter a mandate to the *firm* that defines the limits of the *firm's* discretion, that recommendation, request or advice should be considered a recommendation for the purposes of *COBS 9A.2.1R*. A *firm* should therefore undertake a suitability assessment in relation to any such recommendation, request or advice.

[**Note:** recital 89 to the *MiFID Org Regulation*]

Assessing the extent of the information required

- 9A.2.4 EU 54(2) Investment firms shall determine the extent of the information to be collected from clients in light of all the features of the investment advice or portfolio management services to be provided to those clients. Investment firms shall obtain from clients or potential clients such information as is necessary for the firm to understand the essential facts about the client and to have a reasonable basis for determining, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of providing a portfolio management service, satisfies the following criteria:
- (a) it meets the investment objectives of the client in question, including client's risk tolerance;
  - (b) it is such that the client is able financially to bear any related investment risks consistent with his investment objectives;
  - (c) it is such that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

[**Note:** article 54(2) of the *MiFID Org Regulation*]

#### Professional clients

- 9A.2.5 EU 54(3) Where an investment firm provides an investment service to a professional client it shall be entitled to assume that in relation to the products, transactions and services for which it is so classified, the client has the necessary level of experience and knowledge for the purposes of point (c) of paragraph 2.
- Where that investment service consists in the provision of investment advice to a professional client covered by Section 1 of Annex II to Directive 2014/65/EU, the investment firm shall be entitled to assume for the purposes of point (b) of paragraph 2 that the client is able financially to bear any related investment risks consistent with the investment objectives of that client.

[**Note:** article 54(3) of the *MiFID Org Regulation*]

#### Obtaining information about knowledge and experience

- 9A.2.6 EU 55(1) Investment firms shall ensure that the information regarding a client's or potential client's knowledge and experience in the investment field includes the following, to the extent appropriate to the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved:
- (a) the types of service, transaction and financial instrument with which the client is familiar;



- (b) the nature, volume, and frequency of the client's transactions in financial instruments and the period over which they have been carried out;
- (c) the level of education, and profession or relevant former profession of the client or potential client.

[**Note:** article 55(1) of the *MiFID Org Regulation*]

#### Obtaining information about a client's financial situation

- 9A.2.7 EU 54(4) The information regarding the financial situation of the client or potential client shall include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.

[**Note:** article 54(4) of the *MiFID Org Regulation*]

#### Obtaining information about a client's investment objectives

- 9A.2.8 EU 54(5) The information regarding the investment objectives of the client or potential client shall include, where relevant, information on the length of time for which the client wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.

[**Note:** article 54(5) of the *MiFID Org Regulation*]

#### Reliability of information

- 9A.2.9 EU 54(7) Investment firms shall take reasonable steps to ensure that the information collected about their clients or potential clients is reliable. This shall include, but shall not be limited to, the following:
- (a) ensuring clients are aware of the importance of providing accurate and up-to-date information;
  - (b) ensuring all tools, such as risk assessment profiling tools or tools to assess a client's knowledge and experience, employed in the suitability assessment process are fit-for-purpose and are appropriately designed for use with their clients, with any limitations identified and actively mitigated through the suitability assessment process;
  - (c) ensuring questions used in the process are likely to be understood by clients, capture an accurate reflection of the client's objectives and needs, and the information necessary to undertake the suitability assessment; and
  - (d) taking steps, as appropriate, to ensure the consistency of

client information, such as by considering whether there are obvious inaccuracies in the information provided by clients.

[Note: article 54(7) of the *MiFID Org Regulation*]

#### Maintaining adequate and up-to-date information

- 9A.2.10 EU 54(7) Investment firms having an on-going relationship with the client, such as by providing an on-going advice or portfolio management service, shall have, and be able to demonstrate, appropriate policies and procedures to maintain adequate and up-to-date information about clients to the extent necessary to fulfil the requirements under paragraph 2.

[Note: article 54(7) of the *MiFID Org Regulation*]

#### Discouraging the provision of information

- 9A.2.11 EU 55(2) An investment firm shall not discourage a client or potential client from providing information required for the purposes of Article 25(2) and (3) of Directive 2014/65/EU.

[Note: article 55(2) of the *MiFID Org Regulation*]

#### Reliance on information

- 9A.2.12 EU 55(3) An investment firm shall be entitled to rely on the information provided by its clients or potential clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete.

[Note: article 55(3) of the *MiFID Org Regulation*]

#### Insufficient information

- 9A.2.13 EU 54(8) Where, when providing the investment service of investment advice or portfolio management, an investment firm does not obtain the information required under Article 25(2) of Directive 2014/65/EU, the firm shall not recommend investment services or financial instruments to the client or potential client.

[Note: article 54(8) of the *MiFID Org Regulation*]

- 9A.2.14 G Although a *firm* may not be permitted to make a *personal recommendation* or take a decision to trade because it does not have the necessary information, its *client* may still ask the *firm* to provide another service such as, for example, to arrange a deal or to deal as agent for the *client*. If this happens, the *firm* should ensure that it receives written confirmation of the instructions. The *firm* should also bear in mind the *client's best interests rule* and any obligation it may have under the *rules* relating to appropriateness when providing the different service (see *COBS 10A* (appropriateness (for non-advised services in relation to MiFID, equivalent third country or

optional exemption business)).

#### Identifying the subject of a suitability assessment

- 9A.2.15 EU 54(6) Where a client is a legal person or a group of two or more natural persons or where one or more natural persons are represented by another natural person, the investment firm shall establish and implement policy as to who should be subject to the suitability assessment and how this assessment will be done in practice, including from whom information about knowledge and experience, financial situation and investment objectives should be collected. The investment firm shall record this policy.
- Where a natural person is represented by another natural person or where a legal person having requested treatment as professional client in accordance with Section 2 of Annex II of Directive 2014/65/EU is to be considered for the suitability assessment, the financial situation and investment objectives shall be those of the legal person or, in relation to the natural person, the underlying client rather than of the representative. The knowledge and experience shall be that of the representative of the natural person or the person authorised to carry out transactions on behalf of the underlying client.

[Note: article 54(6) of the *MiFID Org Regulation*]

#### Bundled packages

- 9A.2.16 R Where a *firm* provides a *personal recommendation* recommending a package of services or products bundled pursuant to COBS 6.1-A.2.12R, the *firm* must ensure that the overall bundled package is suitable for the *client*.

[Note: second paragraph of article 25(2) of *MiFID*]

- 9A.2.17 G When considering the suitability of a particular *financial instrument* which is linked directly or indirectly to any form of loan, mortgage or *home reversion plan*, a *firm* should take account of the suitability of the overall transaction. The *firm* should have regard to any applicable suitability *rules* in *MCOB*.

#### Switching

- 9A.2.18 EU 54(11) When providing investment advice or portfolio management services that involve switching investments, either by selling an instrument and buying another or by exercising a right to make a change in regard to an existing instrument, investment firms shall collect the necessary information on the client's existing investments and the recommended new investments and shall undertake an analysis of the costs and benefits of the switch, such that they are reasonably able to demonstrate that the benefits of switching are greater than the costs.

[Note: article 54(11) of the *MiFID Org Regulation*]

#### Adequate policies and procedures

- 9A.2.19 EU 54(9) Investment firms shall have, and be able to demonstrate, adequate policies and procedures in place to ensure that they understand the nature, features, including costs and risks of investment services and financial instruments selected for their clients and that they assess, while taking into account cost and complexity, whether equivalent investment services or financial instruments can meet their client's profile.

[Note: article 54(9) of the *MiFID Org Regulation*]

#### Unsuitability

- 9A.2.20 EU 54(10) When providing the investment service of investment advice or portfolio management, an investment firm shall not recommend or decide to trade where none of the services or instruments are suitable for the client.

[Note: article 54(10) of the *MiFID Org Regulation*]

#### Guidance on assessing suitability

- 9A.2.21 G (1) A transaction may be unsuitable for a *client* due to the risks of the associated *financial instruments*, the type of transaction, the characteristics of the order or the frequency of the trading.
- (2) A series of transactions, each of which are suitable when viewed in isolation may be unsuitable if the recommendation or the decisions to trade are made with a frequency that is not in the best interests of the *client*.
- (3) In the case of *portfolio management*, a transaction might be unsuitable if it would result in an unsuitable portfolio.

[Note: recital 88 to the *MiFID Org Regulation*]

#### Investments subject to restrictions on retail distribution

- 9A.2.22 G (1) *Firms* should note that restrictions and specific requirements apply to the retail distribution of certain *financial instruments*:
- (a) *non-mainstream pooled investments* are subject to a restriction on *financial promotions* (see section 238 of the *Act* and *COBS* 4.12);
- (b) *non-readily realisable securities* are subject to a restriction on *direct offer financial promotions* (see *COBS* 4.7);

- (c) *contingent convertible instruments* and *CoCo funds* are subject to a restriction on sales and on promotions (see *COBS 22.3*);
  - (d) *mutual society shares* are subject to specific requirements in relation to *dealing* and *arranging activities* (see *COBS 22.3*).
- (2) A *firm* should be satisfied that an exemption is available before recommending a *financial instrument* subject to a restriction on distribution to a *retail client*, noting in particular that a *personal recommendation* to invest will generally incorporate a *financial promotion*.
  - (3) In addition to assessing whether the promotion is permitted, a *firm* giving advice on a *financial instrument* subject to a restriction on distribution should comply with their obligations in *COBS 9A* and ensure any *personal recommendation* is suitable for its *client*.
  - (4) In considering its obligations under *COBS 9A*, a *firm* purchasing a *financial instrument* subject to a restriction on distribution on behalf of a *retail client* as part of a discretionary management agreement should exercise particular care to ensure the transaction is suitable and in the *client's* best interests, having regard to the *FCA's* view that such *financial instruments* pose particular risks of inappropriate distribution.
  - (5) A restriction on promotion does not affect a transaction where there has been no prior communication with the *client* in connection with the investment by the *firm* or a person connected to the *firm*. Nonetheless, if promotion of a *financial instrument* to a *retail client* would not have been permitted, then the discretionary manager's decision to purchase it on behalf of the *retail client* should be supported by detailed and robust justification of his assessment of suitability.

Automated or semi-automated systems

9A.2.23	EU	54(1)	Where investment advice or portfolio management services are provided in whole or in part through an automated or semi-automated system, the responsibility to undertake the suitability assessment shall lie with the investment firm providing the service and shall not be reduced by the use of an electronic system in making the personal recommendation or decision to trade.
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[**Note:** second paragraph of article 54(1) of the *MiFID Org Regulation*]

### 9.3 Information to be provided to the client

#### Explaining the reasons for assessing suitability

- 9A.3.1 EU 54(1) Investment firms shall not create any ambiguity or confusion about their responsibilities in the process when assessing the suitability of investment services or financial instruments in accordance with Article 25(2) of Directive 2014/65/EU. When undertaking the suitability assessment, the firm shall inform clients or potential clients, clearly and simply, that the reason for assessing suitability is to enable the firm to act in the client's best interest.

[**Note:** first paragraph of article 54(1) of the *MiFID Org Regulation*]

#### Suitability reports

- 9A.3.2 R (1) This *rule* applies in relation to *investment advice* given to a *retail client*.
- (2) When providing *investment advice*, a *firm* must, before the transaction is concluded, provide the *client* with a *suitability report* in a *durable medium* specifying the advice given and how that advice meets the preferences, objectives and other characteristics of the *client*.
- (2) Where the agreement to buy or sell a *financial instrument* is concluded using a means of distance communication which prevents the prior delivery of the *suitability report*, the *firm* may provide the *suitability report* in a *durable medium* immediately after the *client* is bound by any such agreement, provided both the following conditions are met:
- (a) the *client* has consented to receiving the *suitability report* without undue delay after the conclusion of the transaction; and
- (b) the *firm* has given the *client* the option of delaying the transaction in order to receive the *suitability report* in advance.
- (3) Where a *firm* provides a *portfolio management* service or has informed the *client* that it will carry out periodic assessment of suitability, the periodic report, provided under *COBS 16A.2.1R*, must contain an updated statement of how the *client's* investments meet the preferences, objectives and other characteristics of the *client*.

[**Note:** second and fourth paragraphs of article 25(6) of, and recital (82) to, *MiFID*]

#### Providing a suitability report

- 9A.3.3 EU 54(12) When providing investment advice, investment firms shall provide a report to the retail client that includes an outline of the advice given and how the recommendation provided is suitable for the

retail client, including how it meets the client's objectives and personal circumstances with reference to the investment term required, client's knowledge and experience and client's attitude to risk and capacity for loss.

Investment firms shall draw clients' attention to and shall include in the suitability report information on whether the recommended services or instruments are likely to require the retail client to seek a periodic review of their arrangements.

Where an investment firm provides a service that involves periodic suitability assessments and reports, the subsequent reports after the initial service is established may only cover changes in the services or instruments involved and/or the circumstances of the client and may not need to repeat all the details of the first report.

[Note: article 54(12) of the *MiFID Org Regulation*]

- 9A.3.4 G When providing a *suitability report*, a *firm* should consider the requirements in *COBS 4.2.1R* to ensure that the contents of the suitability report are fair, clear and not misleading.
- 9A.3.5 G Situations that are likely to require a *retail client* to seek a periodic review of their arrangements include where a *client* is likely to need to seek advice to bring a portfolio of investments back in line with the original recommended allocation where there is a probability that the portfolio could deviate from the target asset allocation.

[Note: recital 85 to the *MiFID Org Regulation*]

#### Periodic assessments

- 9A.3.6 R A *firm* must, in good time before it provides its *investment advice*, inform the *client* whether it will provide the *client* with a periodic assessment of the suitability of the *financial instruments* recommended to the *client*.

[Note: article 24(4)(a)(iii) of *MiFID*]

- G *COBS 9A.3.6R* supplements *COBS 2.2A.2R* (information disclosure before providing services (MiFID provisions)).

- 9A.3.7 EU 54(13) Investment firms providing a periodic suitability assessment shall review, in order to enhance the service, the suitability of the recommendations given at least annually. The frequency of this assessment shall be increased depending on the risk profile of the client and the type of financial instruments recommended.

[Note: article 54(13) of the *MiFID Org Regulation*]

#### 9A.4 Record keeping and retention periods for suitability records

- 9A.4.1 G A *firm* to which SYSC 9 applies is required to keep orderly records of its business and internal organisation (see SYSC 9, General rules on recording-keeping). The records may be expected to reflect the different effect of the requirements in this chapter depending on whether the *client* is a *retail client* or a *professional client*; for example, in respect of information about the *client* which the *firm* must obtain and whether the *firm* is required to provide a *suitability report*.
- 9A.4.2 G A *firm* should refer to SYSC 9 for its obligations in relation to record keeping.
- [Note: article 16(7) of MiFID]

Amend the following as shown.

## 10 Appropriateness (for non-MiFID non-advised services)

### 10.1 Application and ~~purpose~~ provisions

- 10.1.1 R ~~This chapter applies to a *firm* which provides *investment services* in the course of *MiFID* or *equivalent third country business* other than making a *personal recommendation* and *managing investments*. [deleted]~~
- 10.1.2 R This chapter applies to a *firm* which *arranges* or *deals* in relation to a *non-readily realisable security*, *derivative* or a *warrant* with or for a *retail client*, other than in the course of *MiFID* or *equivalent third country business*, and the *firm* is aware, or ought reasonably to be aware, that the application or order is in response to a *direct offer financial promotion*.
- 10.1.3 R ~~This chapter applies to a *firm* which assesses appropriateness on behalf of another *MiFID investment firm* so that the other *firm* may rely on the assessment under *COBS 2.4.4R* (reliance on other investment firms: *MiFID* and *equivalent business*). [deleted]~~

#### Related rules

- 10.1.4 G A *firm* that is carrying on a *regulated activity* on a non-advised basis, whether or not the *rules* in this chapter apply to its activities, should also consider whether other *rules* in *COBS* apply. ~~For example, a *firm* carrying on *insurance mediation activity* in relation to a *life policy* that does not involve the provision of advice, should have regard to *COBS 7* (Insurance mediation).~~

### 10.2 Assessing appropriateness: the obligations

- 10.2.1 R ...



- (2) When assessing appropriateness, a *firm*:
- (a) must determine whether the *client* has the necessary experience and knowledge in order to understand the risks involved in relation to the product or service offered or demanded;
  - (b) ~~may assume that a *professional client* has the necessary experience and knowledge in order to understand the risks involved in relation to those particular *investment services* or transactions, or types of transaction or product, for which the *client* is classified as a *professional client*.~~

~~[Note: article 19(5) of *MiFID* and article 36 of the *MiFID implementing Directive*]~~

10.2.2 R ...

~~[Note: article 37(1) of the *MiFID implementing Directive*]~~

10.2.3 R ...

~~[Note: article 37(2) of the *MiFID implementing Directive*]~~

Reliance on information

10.2.4 R ...

~~[Note: article 37(3) of the *MiFID implementing Directive*]~~

...

No duty to communicate firm's assessment of knowledge and experience

10.2.8 G If a *firm* is satisfied that the *client* has the necessary experience and knowledge in order to understand the risks involved in relation to the product or service, there is no duty to communicate this to the *client*. If the *firm* does so, it must not do so in a way that amounts to making a *personal recommendation* unless it complies with the *rules in COBS 9 on suitability*. (suitability (including basic advice)(non-MiFID provisions)).

### 10.3 Warning the client

10.3.1 R ...

~~[Note: article 19(5) of *MiFID*]~~

10.3.2 R ...

~~[Note: article 19(5) of *MiFID*]~~

...

**10.4 Assessing appropriateness: when it need not be done**

- 10.4.1 R (1) A *firm* is not required to ask its *client* to provide information or assess appropriateness if:
- (a) the service only consists of execution and/or the reception and transmission of *client* orders, with or without *ancillary services*, it relates to particular *financial instruments* and is provided at the initiative of the *client*;

...

- (2) The *financial instruments* referred to in (1)(a) are:
- (a) ~~shares admitted to trading on a regulated market or an equivalent third country market (that is, one which is included in the list which is published by the European Commission and updated periodically); or [deleted]~~
- ...
- (c) ~~units in a scheme authorised under the UCITS directive; or [deleted]~~
- (d) other non-complex *financial instruments*.
- (3) A *financial instrument* is non-complex if it satisfies the following criteria:

...

~~[Note: article 19(6) of MiFID and article 38 of the MiFID implementing Directive]~~

- 10.4.2 R If a *client* engages in a course of dealings involving a specific type of product or service through the services of a *firm*, the *firm* is not required to make a new assessment on the occasion of each separate transaction. A *firm* complies with the *rules* in this chapter provided that it makes the necessary appropriateness assessment before beginning that service.

~~[Note: recital 59 to the MiFID implementing Directive]~~

- 10.4.3 R ~~A *client* who has engaged in a course of dealings involving a specific type of product or service beginning before 1 November 2007 is presumed to have the necessary experience and knowledge in order to understand the risks involved in relation to that specific type of product or service. [deleted]~~

~~[Note: recital 59 of the MiFID implementing Directive]~~

## 10.5 Assessing appropriateness: guidance

The initiative of the client

- 10.5.1 G A service should be considered to be provided at the initiative of a *client* (see *COBS* 10.4.1R(1)(a)) unless the *client* demands it in response to a personalised communication from or on behalf of the *firm* to that particular *client* which contains an invitation or is intended to influence the *client* in respect of a specific *financial instrument* or specific transaction.

~~[Note: recital 30 to MiFID]~~

- 10.5.2 G A service can be considered to be provided at the initiative of a *client* notwithstanding that the *client* demands it on the basis of any communication containing a promotion or offer of ~~*financial instruments*~~ *investments* made by any means that by its very nature is general and addressed to the public or a larger group or category of *clients*.

~~[Note: recital 30 to MiFID]~~

Personalised communications

- 10.5.3 G ...
- (2) Communications addressed to a *client* (such as, for example, an email, a telephone call or a letter), may or may not be personalised depending on the content.

...

~~Equivalent third country markets~~

- 10.5.4 G ~~[to insert the reference or hypertext link to the list of equivalent third country markets when available]~~ ~~[deleted]~~

~~[Note: article 19(6) of MiFID]~~

Independent valuation systems

- 10.5.5 G The circumstances in which valuation systems will be independent of the issuer (see *COBS* 10.4.1R(3)(b)) include where they are overseen by a depositary that is regulated as a provider of depositary services in a *EEA State*.

~~[Note: recital 61 to the MiFID implementing Directive]~~

## 10.6 When a firm need not assess appropriateness

...

- 10.6.2 G ~~A *firm* may not need to assess appropriateness if it is able to rely on a recommendation made by an *investment firm* (see *COBS 2.4.5 G* (Reliance on other investment firms: MiFID and equivalent business)). [deleted]~~

...

After COBS 10 (Appropriateness (for non-MiFID non-advised services)) insert the following new chapter. All the text is new and is not underlined.

## **10A Appropriateness (for non-advised MiFID or equivalent third country business)**

### **10A.1 Application**

[**Note:** ESMA has also issued guidelines under article 16(3) of the ESMA Regulation on complex debt instruments and structured deposits. See [LINK to follow].]

#### Application

- 10A.1.1 R This chapter applies to a *firm* which provides *investment services* in the course of *MiFID or equivalent third country business* other than making a *personal recommendation* or carrying out *portfolio management*.
- 10A.1.2 R This chapter applies to a *firm* which assesses appropriateness on behalf of a *MiFID investment firm* so that the other *firm* may rely on the assessment under *COBS 2.4.4R* (Reliance on other investment firms: MiFID and equivalent business).
- Effect of provisions marked EU
- 10A.1.3 R Provisions in this chapter marked “EU” apply in relation to *MiFID optional exemption business* as if they were *rules*. (see also *COBS 1.2.2G*).
- 10A.1.4 R The effect of *GEN 2.2.22AR* is that provisions in this chapter marked “EU” also apply in relation to the *equivalent business of a third country investment firm* as if they were *rules*.

### **10A.2 Assessing appropriateness: the obligations**

- 10A.2.1 R When providing a service to which this chapter applies, a *firm* must ask the *client* to provide information regarding that *client’s* knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded to enable the *firm* to assess whether the service

or product envisaged is appropriate for the *client*.

[**Note:** article 25(3) of *MIFID*]

Bundled packages

- 10A.2.2 R Where a bundle of services or products is envisaged pursuant to *COBS* 6.1-A.2.12R, the assessment made pursuant to *COBS* 10A.2.1R must consider whether the overall bundled package is appropriate.

[**Note:** article 25(3) of *MiFID*]

Assessing a client's knowledge and experience

- 10A.2.3 EU 56(1) Investment firms, shall determine whether that client has the necessary experience and knowledge in order to understand the risks involved in relation to the product or investment service offered or demanded when assessing whether an investment service as referred to in Article 25(3) of Directive 2014/65/EU is appropriate for a client.
- An investment firm shall be entitled to assume that a professional client has the necessary experience and knowledge in order to understand the risks involved in relation to those particular investment services or transactions, or types of transaction or product, for which the client is classified as a professional client.

[**Note:** article 56(1) of the *MiFID Org Regulation*]

Information regarding a client's knowledge and experience

- 10A.2.4 EU 55(1) Investment firms shall ensure that the information regarding a client's or potential client's knowledge and experience in the investment field includes the following, to the extent appropriate to the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved:
- (a) the types of service, transaction and financial instrument with which the client is familiar;
  - (b) the nature, volume, and frequency of the client's transactions in financial instruments and the period over which they have been carried out;
  - (c) the level of education, and profession or relevant former profession of the client or potential client.

[**Note:** article 55(1) of the *MiFID Org Regulation*]

Discouraging the provision of information

- 10A.2.5 EU 55(2) An investment firm shall not discourage a client or potential client from providing information required for the purposes of Article 25(2) and (3) of Directive 2014/65/EU.

[Note: article 55(2) of the *MiFID Org Regulation*]

Reliance on information

- 10A.2.6 EU 55(3) An investment firm shall be entitled to rely on the information provided by its clients or potential clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete.

[Note: article 55(3) of the *MiFID Org Regulation*]

Use of existing information

- 10A.2.7 G When assessing appropriateness, a *firm* may use information it already has in its possession.

Knowledge and experience

- 10A.2.8 G Depending on the circumstances, a *firm* may be satisfied that the *client's* knowledge alone is sufficient for him to understand the risks involved in a product or service. Where reasonable, a *firm* may infer knowledge from experience.

Increasing the client's understanding

- 10A.2.9 G If, before assessing appropriateness, a *firm* seeks to increase the *client's* level of understanding of a service or product by providing information to him, relevant considerations are likely to include the nature and complexity of the information and the *client's* existing level of understanding.

No duty to communicate firm's assessment of knowledge and experience

- 10A.2.10 G If a *firm* is satisfied that the *client* has the necessary experience and knowledge in order to understand the risks involved in relation to the product or service, there is no duty to communicate this to the *client*. If the *firm* does so, it must not do so in a way that amounts to making a *personal recommendation* unless it complies with the *rules* in COBS 9A (suitability, MiFID, equivalent third country and optional exemption business)).

**10A.3 Warning the client**

- 10A.3.1 R (1) If a *firm* considers, on the basis of information received to enable it to assess appropriateness, that the product or service is not appropriate for the *client*, the *firm* must warn the *client*.

- (2) This warning may be provided in a standardised format.

[Note: article 25(3) of *MiFID*]

- 10A.3.2 R (1) If the *client* does not provide the information to enable the *firm* to assess appropriateness, or if the *client* provides insufficient information regarding their knowledge and experience, the *firm* must warn the *client* that the *firm* is not in a position to determine whether the service or product envisaged is appropriate for the *client*.

- (2) This warning may be provided in a standardised format.

[Note: article 25(3) of *MiFID*]

- 10.A.3.3 G If a *client* asks a *firm* to go ahead with a transaction, despite being given a warning by the *firm*, it is for the *firm* to consider whether to do so having regard to the circumstances.

#### 10A.4 Assessing appropriateness: when it need not be done

- 10A.4.1 R (1) A *firm* is not required to ask its *client* to provide information or assess appropriateness if:
- (a) the service:
    - (i) only consists of execution or reception and transmission of *client* orders, with or without *ancillary services*, excluding *ancillary service* (2) in section B of Annex I to *MiFID* (granting of credits or loans), where the relevant credits or loans do not comprise existing credit limits of loans, current accounts and overdraft facilities of *clients*;
    - (ii) relates to particular *financial instruments*; and
    - (iii) is provided at the initiative of the *client*;
  - (b) the *client* has been clearly informed (whether in a standardised format or not) that, in the provision of this service, the *firm* is not required to assess the appropriateness of the *financial instrument* or service provided or offered and that therefore the *client* does not benefit from the protection of the *rules* on assessing appropriateness; and
  - (c) the *firm* complies with its obligations in relation to conflicts of interest.
- (2) The *financial instruments* referred to in (1)(a)(ii) are any of the following:

- (a) shares in companies admitted to trading on:
    - (i) a *regulated market*; or
    - (ii) an equivalent third country market; or
    - (iii) an *MTF*,except shares that embed a derivative and *units* in a collective investment undertaking that is not a *UCITS*; or
  - (b) bonds or other forms of securitised debt admitted to trading on:
    - (i) a *regulated market*; or
    - (ii) an equivalent third country market; or
    - (iii) an *MTF*,except those that embed a derivative or incorporate a structure which makes it difficult for the *client* to understand the risk involved; or
  - (c) *money market instruments*, excluding those that embed a derivative or incorporate a structure which makes it difficult for the *client* to understand the risk involved; or
  - (d) shares or *units* in a *UCITS*, excluding structured *UCITS* as referred to in the second subparagraph of article 36(1) of the *KII Regulation*; or
  - (e) *structured deposits*, excluding those that incorporate a structure which makes it difficult for the *client* to understand the risk of return or the cost of exiting the product before term; or
  - (f) other non-complex *financial instruments*.
- (3) For the purposes of this *rule*, a third country market is considered to be equivalent to a *regulated market* if it is a market in relation to which the Commission has adopted an affirmative equivalence decision in accordance with the requirements in article 4(1)(c) of Directive 2003/71/EC and the condition in article 4(1)(d) of Directive 2003/71/EC is satisfied..

[**Note:** article 25(4) of *MIFID*]

[**Note:** ESMA has published guidelines which specify criteria for the assessment of (i) debt instruments incorporating a structure which makes it difficult for the client to understand the risk involved, and (ii) structured deposits incorporating a structure which makes it difficult for the client to understand the risk of return or the cost of existing the product before term.



The guidelines can be found here: [LINK to follow].]

#### Non-complex financial instruments

10A.4.2	EU	57	<p>A financial instrument which is not explicitly specified in Article 25(4)(a) of Directive 2014/65/EU shall be considered as non-complex for the purposes of Article 25(4)(a)(vi) of Directive 2014/65/EU if it satisfies the following criteria:</p> <ul style="list-style-type: none"> <li>(a) it does not fall within Article 4(1)(44)(c) of, or points (4) to (11) of Section C of Annex I to Directive 2014/65/EU;</li> <li>(b) there are frequent opportunities to dispose of, redeem, or otherwise realise that instrument at prices that are publicly available to market participants and that are either market prices or prices made available, or validated, by valuation systems independent of the issuer;</li> <li>(c) it does not involve any actual or potential liability for the client that exceeds the cost of acquiring the instrument;</li> <li>(d) it does not incorporate a clause, condition or trigger that could fundamentally alter the nature or risk of the investment or pay out profile, such as investments that incorporate a right to convert the instrument into a different investment;</li> <li>(e) it does not include any explicit or implicit exit charges that have the effect of making the investment illiquid even though there are technically frequent opportunities to dispose of, redeem or otherwise realise it;</li> <li>(f) adequately comprehensive information on its characteristics is publicly available and is likely to be readily understood so as to enable the average retail client to make an informed judgment as to whether to enter into a transaction in that instrument.</li> </ul>
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[Note: article 57 of the *MiFID Org Regulation*]

### 10A.5 Assessing appropriateness: guidance

#### The initiative of the client

10A.5.1	G	<p>A service should be considered to be provided at the initiative of a <i>client</i> (see <i>COBS</i> 10A.4.1R(1)(a)(iii)), unless the <i>client</i> demands it in response to a personalised communication from or on behalf of the <i>firm</i> to that <i>client</i> which contains an invitation or is intended to influence the <i>client</i> in respect of a specific <i>financial instrument</i> or specific transaction.</p>
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[Note: recital 85 to MIFID]

- 10A.5.2 G A service can be considered to be provided at the initiative of a *client* notwithstanding that the *client* demands it on the basis of any communication containing a promotion for, or offer of, *financial instruments* made by any means and that by its very nature is general and addressed to the public or a larger group or category of *clients*.

[Note: recital 85 to MIFID]

Personalised communications

- 10A.5.3 G (1) Communications to the world at large, such as those in newspapers or in billboards, are likely to be by their very nature general and therefore not personalised communications.
- (2) Communications addressed to a *client* (such as, for example, an email, telephone call or letter), may or may not be personalised depending on the content.
- (3) A communication is not personalised solely because it contains the name and address of the *client* or because a mailing list has been filtered.
- (4) If a *firm* is satisfied that a communication does not contain any personalised content, it may wish to make clear that it does not intend the communication to be personalised and that the personal circumstances of the recipient have not been taken into account.

## 10A.6 When a firm need not assess appropriateness

- 10A.6.1 G A *firm* need not assess appropriateness if it is receiving or transmitting an order in relation to which it has assessed suitability under COBS 9A (suitability (MiFID, equivalent third country and optional exemption business)).
- 10A.6.2 G A *firm* may not need to assess appropriateness if it is able to rely on a recommendation made by an *investment firm* (see COBS 2.4.5G (Reliance on other investment firms: MiFID and equivalent business)).

## 10A.7 Record keeping and retention periods for appropriateness records

- 10A.7.1 G A *firm* is required to keep orderly records of its business and internal organisation, including all services and transactions undertaken by it. The records may be expected to include the *client* information a *firm* obtains to assess appropriateness and should be adequate to indicate what the assessment was.

- 10A.7.2 EU 56(2) Investment firms shall maintain records of the appropriateness assessments undertaken which shall include the following:
- (a) the result of the appropriateness assessment;
  - (b) any warning given to the client where the investment service or product purchase was assessed as potentially inappropriate for the client, whether the client asked to proceed with the transaction despite the warning and, where applicable, whether the firm accepted the client's request to proceed with the transaction;
  - (c) any warning given to the client where the client did not provide sufficient information to enable the firm to undertake an appropriateness assessment, whether the client asked to proceed with the transaction despite this warning and, where applicable, whether the firm accepted the client's request to proceed with the transaction.

[Note: article 56(2) of the *MiFID Org Regulation*]

- 10A.7.2 G A *firm* should refer to SYSC 9 for its obligations in relation to record keeping. This requires records kept for the purposes of this chapter to be retained for a period of at least five years.

## 11 Dealing and managing

### 11.1 Application

...

~~Application to section on the use of dealing commission~~

- 11.1.3 R ~~The section on the use of dealing commission applies to a *firm* that acts as an *investment manager*. [deleted]~~

Chapter 11.2 (Best execution) is deleted in its entirety. The deleted text is not shown.

[Editor's Note: The deletion of this chapter is subject to the review of the Specialist Regimes in COBS 18, except for COBS 18.5, in relation to MiFID II]

### 11.2 Best execution [deleted]

Insert the new 11.2A and 11.2B after COBS 11.1 (Application). All of the text is new and is

not underlined.

## 11.2A Best execution

- 11.2A.1 G (1) This chapter contains a number of provisions marked with the status letters “EU”, which have been selectively reproduced from the *MiFID Org Regulation*.
- (2) Where this chapter reproduces or refers to provisions of the *MiFID Org Regulation* they are directly applicable to *MiFID Org Regulation firms* in relation to their *MiFID business*. Such *firms* should use the Official Journal of the European Union for a comprehensive statement of their obligations under the *MiFID Org Regulation*.
- (3) The purpose of *COBS* 11.2A.2R is that these provisions are also applied in relation to other business and to other *firms* to which this chapter applies, as stated in that *rule*.
- 11.2A.2 R (1) Subject to (2), (3), and (4), the following provisions apply to a *firm’s* business other than *MiFID business* as if they were *rules*:
- (a) provisions within this chapter marked “EU”; and
- (b) *COBS* 1 Annex 1EU.
- (2) The following provisions do not apply to *MiFID optional exemption firm’s* business):
- (a) the part of the first sub-paragraph of article 65(6) to the *MiFID Org Regulation* (reproduced at *COBS* 11.2A.21EU) that reads:
- “In particular, when the investment firm select other firms to provide order execution services, it shall summarise and make public, on an annual basis, for each class of financial instruments, the top five investment firms in terms of trading volumes where it transmitted or placed client orders for execution in the preceding year and information on the quality of execution obtained. The information shall be consistent with the information published in accordance with the technical standards developed under Article 27(10)(b) of Directive 2014/65/EU.”; and
- (b) *COBS* 11 Annex 1EU.
- (3) (1) The following provisions contain specific modifications for *management companies*:
- (a) *COBS* 11.2A.9R;

- (b) COBS 11.2A.11R;
- (c) COBS 11.2A.26R; and
- (d) COBS 11.2A.37R.

(4) Any references within those provisions marked “EU” or within COBS 1 Annex 1EU to other provisions of EU law must be interpreted in light of the purpose of this *rule*.

- 11.2A.3 G (1) COBS 11.2A.2R(4) has the effect that where a provision of an article of the *MiFID Org Regulation* includes a reference or cross reference to another part of the *MiFID Org Regulation*, that reference or cross reference is given the same meaning for the purposes of COBS 11.2A.2R.
- (2) *Firms* subject to COBS 11.5A.2R should use the text of the preamble to any relevant provision marked “EU” in order to interpret any such references or cross-reference.

Obligation to execute orders on terms most favourable to the client

- 11.2A.4 R (1) A *firm* must take all sufficient steps to obtain, when executing orders, the best possible results for its *clients* taking into account the *execution factors*.
- (2) The *execution factors* to be taken into account are price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of an order.

[**Note:** article 27(1) of *MiFID* and article 25(2) of the *UCITS implementing Directive*]

- 11.2A.5 R A *firm’s* own commissions and the costs for executing an order in each of the eligible *execution venues* must be taken into account when assessing and comparing the results that would be achieved for a *client* by executing the order on each of the *execution venues* listed in the *firm’s* execution policy that is capable of executing that order.

[**Note:** article 27(1) of *MiFID*]

- 11.2A.6 R A *firm* must not receive any remuneration, discount or non-monetary benefit for routing *client* orders to a particular *trading venue* or *execution venue* which would infringe the requirements on conflicts of interests (as set out in SYSC 10) or inducements (as set out in COBS 2.3).

[**Note:** article 27(2) of *MiFID*]

Execution of decisions by UCITS management companies to deal on behalf of the schemes they manage

- 11.2A.7 R *A management company* must, in relation to each *UCITS scheme* or *EEA UCITS scheme* it manages, act in the best interests of the *scheme* when *executing* decisions to deal on its behalf in the context of the management of its portfolio, and *COBS 11.2A.4R* applies in relation to all such decisions.

[**Note:** article 25(1) of the *UCITS implementing Directive*]

Best execution criteria

- 11.2A.8 EU Article 64 of the *MiFID Org Regulation* sets out best execution criteria.

- 64 (1) When executing client orders, investment firms shall take into account the following criteria for determining the relative importance of the factors referred to in Article 27(1) of Directive 2014/65/EU:
- (a) the characteristics of the client including the categorisation of the client as retail or professional;
  - (b) the characteristics of the client order, including where the order involves a securities financing transaction (SFT);
  - (c) the characteristics of financial instruments that are the subject of that order;
  - (d) the characteristics of the execution venues to which that order can be directed.

For the purpose of the Article and Articles 65 and 66, ‘execution venue’ includes a regulated market, an MTF, an OTF, a systematic internaliser, or a market maker or other liquidity provider or an entity that performs a similar function in a third country to the function performed by any of the foregoing.

- (2) An investment firm satisfied its obligation under Article 27(1) of Directive 2014/65/EU to take all sufficient steps to obtain the best possible result for a client to the extent that it executes an order or a specific aspect of an order following specific instructions from the client relating to the order or the specific aspect of the order.
- (3) Investment firms shall not structure or charge their commissions in such a way as to discriminate unfairly between execution venues.
- (4) When executing orders or taking decision to deal in OTC products including bespoke products, the investment firm shall check the fairness of the price proposed to the client, by gathering market data used in the estimation of the price

of such product and, where possible, by comparing with similar or comparable products.

11.2A.9 R Article 64 of the *MiFID Org Regulation*, reproduced at COBS 11.2A.8EU, applies as follows for a *management company* providing *collective portfolio management services*:

- (1) article 64(1)(a) does not apply;
- (2) instead, when *executing* a *client* order, a *management company* must take into account the objectives, investment policy and risks specific to the *UCITS scheme* or *EEA UCITS scheme* as indicated in its *prospectus* or *instrument constituting the fund* when determining the relative importance of the factors referred to in article 27(1) of *MiFID*; and
- (3) the remaining provisions of article 64 apply as *rules* as a result of COBS 11.2A.2R and are unmodified.

[**Note:** article 25(2)(a) of the *UCITS implementing Directive*]

11.2A.10 EU Article 66(4) to (8) of the *MiFID Org Regulation* sets out requirements concerning the provision of information to *clients*.

- 66 (4) Where investment firms apply different fees depending on the execution venue, the firm shall explain these differences in sufficient detail in order to allow the client to understand the advantages and the disadvantages of the choice of a single execution venue.
- (5) Where investment firms invite clients to choose an execution venue, fair, clear and not misleading information shall be provided to prevent the client from choosing one execution venue rather than another on the sole basis of the price policy applied by the firm.
- (6) Investment firms shall only receive third-party payments that comply with Article 24(9) of Directive 2014/65/EU and shall inform clients about the inducements that the firm may receive from the execution venues. The information shall specify the fees charged by the investment firm to all counterparties involved in the transaction, and where the fees vary depending on the client, the information shall indicate the maximum fees or range of the fees that may be payable.
- (7) Where an investment firm charges more than one participant in a transaction, in compliance with Article 24(9) of Directive 2014/65/EC and its implementing measures, the firm shall inform its client of the value of any monetary or non-monetary benefits received by the firm.

- (8) Where a client makes reasonable and proportionate requests for information about its policies or arrangements and how they are reviewed to an investment firm, that investment firm shall answer clearly and within a reasonable time.

- 11.2A.11 R Article 66(4) to (8) of the *MiFID Org Regulation*, reproduced at COBS 11.2A.10EU, applies as follows for a *management company* providing *collective portfolio management services*:
- (1) article 66(4) and (5) do not apply;
  - (2) article 66(6) to (8) apply as *rules* as a result of COBS 11.2A.2R; and
  - (3) references to article 24(9) of Directive 2014/65/EU (“MiFID”) are replaced with reference to COBS 2.3.1R.
- 11.2A.12 R Whenever there is a specific instruction from the *client*, a *firm* (other than a *management company* providing *collective portfolio management services*) must execute the order following the specific instruction.
- [Note: article 27(1) of *MiFID*]
- Application of best execution obligation
- 11.2A.13 G The obligation to take all sufficient steps to obtain the best possible result for its *clients* (see COBS 11.2A.4R) should apply where a *firm* owes contractual or agency obligations to the *client*.
- [Note: recital 91 to, and article 27(1) of, *MiFID*]
- 11.2A.14 G Dealing on own account with *clients* by a *firm* should be considered as the execution of *client* orders, and therefore subject to the requirements under *MiFID*, in particular, those obligations in relation to best execution.
- [Note: first sentence, recital 103 to the *MiFID Org Regulation*]
- 11.2A.15 G This *guidance* applies where a *firm* provides a quote to a *client* and that quote would meet the *firm*'s obligations to take all sufficient steps to obtain the best possible result for its *clients* under COBS 11.2A.4R to COBS 11.2A.5R and where the *firm* executed that quote at the time it was provided. The *firm* will meet those same obligations if it executes its quote after the *client* accepts it, provided that, taking into account the changing market conditions and the time elapsed between the offer and acceptance of the quote, the quote is not manifestly out of date.
- [Note: second sentence, recital 103 to the *MiFID Org Regulation*]
- 11.2A.16 G The obligation to deliver the best possible result when executing *client* orders applies in relation to all types of *financial instruments*. However, given the differences in market structures and the structure of *financial*



*instruments*, it may be difficult to identify and apply a uniform standard of, and procedure for, best execution that would be valid and effective for all classes of instrument. Best execution obligations should therefore be applied to take into account the different circumstances surrounding the execution of orders for particular types of *financial instruments*. For example, transactions involving a customised *OTC financial instrument* with a unique contractual relationship tailored to the circumstances of the *client* and the *firm* may not be comparable for best execution purposes with transactions involving *shares* traded on centralised *execution venues*. As best execution obligations apply to all *financial instruments*, irrespective of whether they are traded on *trading venues* or *OTC*, *firms* should gather relevant market data in order to check whether the *OTC* price offered for a *client* is fair and delivers on the best execution obligation.

[**Note:** recital 104 to the *MiFID Org Regulation*]

- 11.2A.17 G A *firm* would be considered to structure or charge its commissions in a way which discriminates unfairly between *execution venues* if it charged a different commission or spread to *clients* for execution on different *execution venues* and that difference did not reflect actual differences in the cost to the *firm* of executing on those venues.

[**Note:** recital 95 to *MiFID*]

- 11.2A.18 G The provisions of this section which provide that costs of execution include a *firm's* own commission or fees charged to the *client* for the provision of an *investment service* should not apply for the purpose of determining what *execution venues* must be included in the *firm's* execution policy in accordance with *COBS* 11.2A.23R.

[**Note:** recital 94 to *MiFID*]

- 11.2A.19 G When a *firm* executes an order following specific instructions from the *client*, it should be treated as having satisfied its best execution obligations only in respect of the part or aspect of the order to which the *client* instructions relate. The fact that the *client* has given specific instructions which cover one part or aspect of the order should not be treated as releasing the *firm* from its best execution obligations in respect of any other parts or aspects of the *client* order that are not covered by such instructions.

[**Note:** recital 102 to the *MiFID Org Regulation*]

- 11.2A.20 G A *firm* should not induce a *client* to instruct it to execute an order in a particular way, by expressly indicating or implicitly suggesting the content of the instruction to the *client*, when the *firm* ought reasonably to know that an instruction to that effect is likely to prevent it from obtaining the best possible result for that *client*. However, this should not prevent a *firm* inviting a *client* to choose between two or more specified *trading venues*, provided that those venues are consistent with the execution policy of the *firm*.

[**Note:** recital 102 to the *MiFID Org Regulation*]

- 11.2A.21 G *Dealing on own account* when executing *client* orders includes the execution by *firms* of orders from different *clients* on a matched principal basis (back-to-back trading). Such activities are regarded as acting as *principal* and are subject to the requirements of this chapter in relation to both execution of orders on behalf of *clients* and *dealing on own account*.

[**Note:** recital 24 to *MiFID*]

- 11.2A.22 G A *firm* transmitting or placing orders with other entities for execution may select a single entity for execution only where the *firm* is able to show that this provides the best possible result for their *clients* on a consistent basis and where they can reasonably expect that the selected entity will enable them to obtain results for *clients* that are at least as good as the results that could reasonably be expected from using alternative entities for execution. This reasonable expectation should be supported by relevant data published in accordance with *COBS* 11.2A.52R or by internal analysis conducted by *investment firms*.

[**Note:** recital 100 to the *MiFID Org Regulation*]

- 11.2A.23 G An *investment firm* executing orders should be able to include a single *execution venue* in their policy only where they are able to show that this allows them to obtain best execution for their *clients* on a consistent basis. *Investment firms* should select a single *execution venue* only where they can reasonably expect that the selected *execution venue* will enable them to obtain results for *clients* that are at least as good as the results that they could reasonably expect from using alternative *execution venues*. This reasonable expectation must be supported by relevant data published in accordance with *COBS* 11.2A.52R or by other internal analyses conducted by *investment firms*.

[**Note:** recital 108 to the *MiFID Org Regulation*]

Management companies: execution and transmission of orders

- 11.2A.24 G (1) A *management company* should, for each *UCITS scheme* or *EEA UCITS scheme* it manages, act in the best interests of the *scheme* when directly executing orders to deal on its behalf or when transmitting those orders to third parties.
- (2) When executing orders on behalf of any such *scheme* it manages, a *management company* is expected to take all reasonable steps to obtain the best possible result for the *scheme* on a consistent basis, taking into account price, costs, speed, likelihood of execution and settlement, size and nature of the order or any other consideration relevant to the execution of the order.

[**Note:** recital 19 to the *UCITS implementing Directive*]

Duty of portfolio managers, receivers and transmitters to act in client's best interest

11.2A.25 EU Article 65 of the *MiFID Org Regulation* sets out the duty of *firms* carrying out certain activities to act in the best interests of the *client*.

- 65 (1) Investment firms, when providing portfolio management, shall comply with the obligation under Article 24(1) of Directive 2014/65/EU to act in accordance with the best interests of their clients when placing orders with other entities for execution that result from decisions by the investment firm to deal in financial instruments on behalf of its client.
- (2) Investment firms, when providing the service of reception and transmission of orders, shall comply with the obligation under Article 24(1) of Directive 2014/65/EU to act in accordance with the best interests of their clients when transmitting client orders to other entities for execution.
- (3) In order to comply with paragraphs 1 or 2, investment firms shall comply with paragraphs 4 to 7 of this Article and Article 64(4).
- (4) Investment firms shall take all sufficient steps to obtain the best possible result for their clients taking into account the factors referred to in Article 27(1) of Directive 2014/65/EU. The relative importance of these factors shall be determined by reference to the criteria set out in Article 59(1) and, for retail clients, to the requirement under Article 27(1) of Directive 2014/65/EU.
- An investment firm satisfied its obligations under paragraph 1 or 2, and is not required to take the steps mentioned in this paragraph, to the extent that it follows specific instructions from its client when placing an order with, or transmitting an order to, another entity for execution.
- (5) Investment firms shall establish and implement a policy that enables them to comply with the obligation in paragraph 4. The policy shall identify, in respect of each class of instruments, the entities with which the orders are placed or to which the investment firm transmits orders for execution. The entities identified shall have execution arrangements that enable the investment firm to comply with its obligations under this Article when it places or transmits orders to that entity for execution.
- (6) Investment firms shall provide information to their clients on the policy established in accordance with paragraph 5 and paragraphs 2-9 of Article 66. Investment firms shall provide clients with appropriate information about the firm and its

services and the entities chose for execution. In particular, when the investment firm select other firms to provide order execution services, it shall summarise and make public, on an annual basis. For each class of financial instruments, the top five investment firms in terms of trading volumes where it transmitted or placed client orders for execution in the preceding year and information on the quality of execution obtained. The information shall be consistent with the information published in accordance with the technical standards developed under Article 27(10)(b) of Directive 2014/65/EU.

Upon reasonable request from a client, investment firms shall provide its clients or potential clients with information about entities where the orders are transmitted or placed for execution.

- (7) Investment firms shall monitor on a regular basis the effectiveness of the policy established in accordance with paragraph 5 and, in particular, shall monitor the execution quality of the entities identified in that policy and, where appropriate, correct any deficiencies.

Investment firms shall review the policy and arrangements at least annually. Such a review shall also be carried out whenever a material change occurs that affects the firm's ability to continue to obtain the best possible result for their clients.

Investment firms shall assess whether a material change has occurred and shall consider making changes to the execution venues or entities on which they place significant reliance in meeting the overarching best execution requirement.

A material change shall be a significant event that could impact parameters of best execution such as cost, price, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order.

- (8) This Article shall not apply where the investment firm that provides the service of portfolio management or reception and transmission of orders also executes the orders received or the decisions to deal on behalf of its client's portfolio. In those cases Article 27 of Directive 2014/65/EU shall apply.

11.2A.26 R Article 65 of the *MiFID Org Regulation*, reproduced at COBS 11.2A.25EU, applies as follows to a *management company* providing *collective portfolio management services*:

- (1) articles 65(2), 65(3) and 65(4)(second paragraph) do not apply;
- (2) (a) the first sentence of article 65(6) is replaced with "A *management company* must make available to *unitholders*

appropriate information on the policy established in accordance with paragraphs (2), (3)(a)-(e) and (3)(g)(first paragraph), (6),(7) and (8) of article 66, and on any material changes to this policy.”; and

(b) the remaining references to “client” in article 65(6) shall be read as *unitholders*;

(3) paragraphs (1), (2) and (3) of article 65(7) apply as *rules* as a result of COBS 11.2A.2R;

(4) paragraph 4 of article 65(7) applies as *guidance* instead of a *rule*; and

(5) article 65(1), 65(4)(first paragraph), 65(5) and 65(8) apply as *rules* as a result of COBS 11.2A.2R and are unmodified.

11.2A.27 R A *management company* must be able to demonstrate that it has placed orders on behalf of any *UCITS scheme* or *EEA UCITS scheme* it manages in accordance with the policy referred to article 65(5) of the *MiFID Org Regulation* reproduced at COBS 11.2A.25EU.

[**Note:** article 26(4) of the *UCITS implementing Directive*]

11.2A.28 G This section is not intended to require a duplication of effort as to best execution between a *firm* which provides the service of reception and transmission of orders or *portfolio management* and any *firm* to which that *firm* transmits its orders for execution.

[**Note:** recital 106 to the *MiFID Org Regulation*]

Requirement for order execution arrangements including an order execution policy

11.2A.29 R A *firm* must establish and implement effective arrangements for complying with the obligation to take all sufficient steps to obtain the best possible results for its *clients*. In particular, the *firm* must establish and implement an order execution policy to allow it to obtain, in accordance with COBS 11.2A.4R, the best possible result for the execution of *client* orders.

[**Note:** article 27(4) of *MiFID* and article 25(3)(first paragraph) of the *UCITS implementing Directive*]

11.2A.30 R The order execution policy must include, in respect of each class of *financial instruments*, information on the different *execution venues* where the *firm* executes its *client* orders and the factors affecting the choice of *execution venue*. It must at least include those *execution venues* that enable the *firm* to obtain on a consistent basis the best possible result for the execution of *client* orders.

[**Note:** article 27(5) of *MiFID*]

- 11.2A.31 R (1) A *firm* must provide appropriate information to its *clients* on its order execution policy.
- (2) That information must explain clearly how orders will be executed by the *firm* for the *clients*.
- (3) The information must include sufficient details and be provided in a way that can be easily understood by *clients*.

[**Note:** article 27(5) of *MiFID*]

- 11.2A.32 R (1) *COBS* 11.2A.31R does not apply to a *management company* providing *collective portfolio management services*.
- (2) Instead, a *management company* must make available appropriate information on its execution policy and on any material changes to that policy to the *unitholders* of each *scheme* it manages.

[**Note:** article 25(3)(second part of the second paragraph) of the *UCITS implementing Directive*]

- 11.2A.33 G When a *management company* providing *collective portfolio management services* makes available appropriate information on its execution policy in accordance with *COBS* 11.2A.32R, it should comply with article 66(2) and (3) of the *MiFID Org Regulation* as modified by *COBS* 11.2A.37R.

- 11.2A.34 R (1) A *firm* (other than a *management company* providing *collective portfolio management services*) must obtain the prior consent of its *clients* to the execution policy.
- (2) In the case of a *management company* providing *collective portfolio management services* for an *ICVC* that is a *UCITS scheme*, or for an *EEA UCITS scheme* that is structured as an investment company, the *management company* must obtain the prior consent of the *ICVC* or investment company to the execution policy.
- (3) In the case of a *management company* that is the *ACD* of an *ICVC* that is a *UCITS scheme*, (2) does not apply where the *ACD* is the sole *director* of the *ICVC*.

[**Note:** article 27(5) of *MiFID* and article 25(3)(first part of the second paragraph) of the *UCITS implementing Directive*]

- 11.2A.35 R (1) Where a *firm*'s order execution policy provides for the possibility that *client* orders may be executed outside a *trading venue*, a *firm* must, in particular, inform its *clients* about that possibility.
- (2) A *firm*, other than a *management company* subject to *COBS* 11.2A.34R, must obtain the express prior consent of its *clients* before proceeding to execute their orders outside a *trading venue*.

- (3) A *firm* may obtain such consent either in the form of a general agreement or in respect of individual transactions.

[**Note:** article 27(5) of *MiFID*]

- 11.2A.36 EU Article 66(1) to (3) of the *MiFID Org Regulation* sets out requirements concerning execution policies

- 66 (1) Investment firms shall review, at least on an annual basis execution policy establishes pursuant to Article 27(4) of Directive 2014/65/EU, as well as their order execution arrangements.
- Such a review shall also be carried out whenever a material change as defined in Article 65(7) occurs that affects the firm's ability to continue to obtain the best possible result for the execution of its client orders on a consistent basis using the venues included in its execution policy. An investment firm shall assess whether a material change has occurred and shall consider making changes to the relative importance of the best execution factors in meeting the overarching best execution requirement.
- (2) The information on the execution policy shall be customised depending on the class of financial instrument and type of the service provided and shall include information set out in paragraphs 3 to 9.
- (3) Investment firms shall provide clients with the following details on their execution policy in good time prior to the provision of the service:
- (a) an account of the relative importance the investment firm assigns, in accordance with the criteria specified in Article 27(1) of Directive 2014/65EU, or the process by which the firm determines the relative importance of those factors.
  - (b) a list of the execution venues on which the firm places significant reliance in meeting its obligation to take all reasonable steps to obtain on a consistent basis the best possible result for the execution of client orders and specifying which execution venues are issued for each class of financial instruments, for retail client orders, professional client orders and SFTs;
  - (c) a list of factors used to select an execution venue, including qualitative factors such as clearing

schemes, circuit breakers, scheduled actions, or any other relevant consideration, and the relative importance of each factor; The information about the factors used to select an execution venue for execution shall be consistent with the controls used by the firm to demonstrate to clients that best execution has been achieved in a consistent basis when reviewing the adequacy of its policy and arrangements;

- (d) how the execution factors of price costs, speed, likelihood of execution and any other relevant factors are considered as part of all sufficient steps to obtain the best possible result for the client;
- (e) where applicable, information that the firm executes orders outside a trading venue, the consequences, for example counterparty risk arising from execution outside a trading venue, and upon client request, additional information about the consequences of this means of execution;
- (f) a clear and prominent warning that any specific instruction from a client may prevent the firm from taking the steps that it has designed and implemented in its execution policy to obtain the best possible result for the execution of those orders in respect of the elements covered by those instructions;
- (g) a summary of the selection process for execution venues, execution strategies employed, the procedures and process used to analyse the quality of execution obtained and how the firms monitor and verify that the best possible results were obtained for clients.

That information shall be provided in a durable medium, or by means of a website (where that does not constitute a durable medium) provided that the conditions specified in Article 3(2) are satisfied.

11.2A.37 R Article 66(1) to (3) of the *MiFID Org Regulation*, reproduced at *COBS 11.2A.36EU*, applies as follows for a *management company* providing *collective portfolio management services*:

- (1) article 66(1) of the *MiFID Org Regulation* reproduced at *COBS 11.2A.36EU* does not apply;



- (2) instead, a *management company* must:
- (a) monitor the effectiveness of its order execution arrangements and execution policy on a regular basis in order to identify and, where appropriate, correct any deficiencies; and
  - (b) review annually its execution policy, as well as its order execution arrangements. The review must also be carried out whenever a material change occurs that affects the *management company's* ability to continue to obtain the best possible result for the *UCITS scheme*, or for the *EEA UCITS scheme*;

[**Note:** article 25(4)(first paragraph) and article 25(4)(second paragraph) of the *UCITS implementing Directive*]

- (3) article 66(3)(f) and 66(3)(g)(second paragraph) do not apply; and
- (4) article 66(2), 66(3)(a) to (e) and (g)(first paragraph), apply as *rules* as a result of *COBS 11.2A.2R* and are unmodified.

- 11.2A.38 G (1) When establishing its execution policy in accordance with *COBS 11.2A.25R* a *firm* should determine the relative importance of the factors mentioned in *COBS 11.2A.4R(2)*, or at least establish the process by which it determines the relative importance of these factors, so that it can deliver the best possible result to its *clients*. Ordinarily, the *FCA* would expect that price will merit a high relative importance in obtaining the best possible result for *professional clients*. However, in some circumstances for some *clients*, orders, *financial instruments* or markets, the policy may appropriately determine that other *execution factors* are more important than price in obtaining the best possible execution result.
- (2) In order to comply with the obligation of best execution, a *firm*, when applying the criteria for best execution for *professional clients*, will typically not use the same *execution venues* for *securities financing transactions* and other transactions. This is because the *securities financing transactions* are used as a source of funding subject to a commitment that the borrower will return equivalent securities on a future date and the terms of the *securities financing transactions* are typically defined bilaterally between the *counterparties* ahead of the execution. Therefore, the choice of *execution venues* for *securities financing transactions* is more limited than in the case of other transactions, given that it depends on the particular terms defined in advance between the *counterparties* and on whether there is a specific demand on those *execution venues* for the *financial instruments* involved. As a result, the order execution policy established by *firms* should take into account the particular

characteristics of *securities financing transactions* and it should list separately *execution venues* used for *securities financing transactions*.

[Note: recital 99 to the *MiFID Org Regulation*]

- 11.2A.39 G (1) A *firm* should apply its execution policy to each *client* order that it executes with a view to obtaining the best possible result for the *client* in accordance with that policy.
- (2) The obligation to take all sufficient steps to obtain the best possible result for the *client* should not be treated as requiring a *firm* to include in its execution policy all available *execution venues*.

[Note: recital 99 to the *MiFID Org Regulation*]

- 11.2A.40 G The provisions of this section as to execution policy are without prejudice to the general obligation of a *firm* to monitor the effectiveness of its order execution arrangements and policy and assess the *execution venues* in its execution policy on a regular basis.

[Note: recital 105 to the *MiFID Org Regulation*]

Monitoring and review of the order execution arrangements including the order execution policy

- 11.2A.41 R A *firm* must monitor the effectiveness of its order execution arrangements and execution policy in order to identify and, where appropriate, correct any deficiencies. In particular it must assess, on a regular basis, whether the *execution venues* included in the order execution policy provide for the best possible result for the *client* or whether it needs to make changes to its execution arrangements taking into account the information published in accordance with *COBS* 11.2A.50R and *COBS* 11.2A.52R. The *firm* must notify *clients* of any material changes to its order execution arrangements or execution policy.

[Note: article 27(7) of *MiFID*]

- 11.2A.42 R (1) A *firm*, other than a *management company* providing *collective portfolio management*, must be able to demonstrate to its *clients*, at their request, that it has executed their orders in accordance with its execution policy.
- (2) A *firm*, other than a *management company* providing *collective portfolio management*, must be able to demonstrate to the *FCA*, at the request of that authority, its compliance with *COBS* 11.2A.4R and with the related provisions in this chapter which require *firms* to execute orders on terms most favourable to the *client*.
- (3) A *management company* must be able to demonstrate that it has executed orders on behalf of any *UCITS scheme* or *EEA UCITS*

*scheme* it manages in accordance with its execution policy.

[**Note:** article 27(8) of *MiFID* and article 25(5) of the *UCITS implementing Directive*]

- 11.2A.43 G In order to obtain the best execution for a *client*, a *firm* should compare and analyse relevant data, including that made public in accordance with article 27(3) of *MiFID* and respective implementing measures.

[**Note:** recital 107 to the *MiFID Org Regulation*]

- 11.2A.44 R *COBS* 11.2A.45R to *COBS* 11.2A.49G do not apply to a *management company* providing *collective portfolio management services*.

- 11.2A.45 R Where a *firm* executes an order on behalf of a *retail client*, the best possible result must be determined in terms of the total consideration, representing the price of the *financial instrument* and the costs related to execution, which must include all expenses incurred by the *client* which are directly related to the execution of the order, including *execution venue* fees, clearing and settlement fees and any other fees paid to third parties involved in the execution of the order.

[**Note:** article 27(1) of *MiFID*]

- 11.2A.46 G When a *firm* executes a *retail client's* order in the absence of specific *client* instructions, for the purposes of ensuring that the *firm* obtains the best possible result for the *client*, the *firm* should take into consideration all factors that will enable it to deliver the best possible result in terms of the total consideration, representing the price of the *financial instrument* and the costs related to execution.

[**Note:** recital 101 to the *MiFID Org Regulation*]

- 11.2A.47 EU Article 66(9) of the *MiFID Org Regulation* sets out requirements concerning the provision to *retail clients* of a summary of its execution policy.

66 (9) Where an investment firm executes orders for retail clients, it shall provide those clients with a summary of the relevant policy, focused on the total cost they incur. The summary shall also provide a link to the most recent execution quality data published in accordance with Article 27(3) of Directive 2014/65/EC for each execution venue listed by the investment firm in its execution policy.

- 11.2A.48 G Speed, likelihood of execution and settlement, the size and nature of the order, market impact and any other implicit transaction costs may be given precedence over the immediate price and cost consideration only insofar as they are instrumental in delivering the best possible result in terms of the total consideration to the *retail client*.

[**Note:** recital 101 to the *MiFID Org Regulation*]

- 11.2A.49 G The obligation to deliver best execution for a *retail client* where there are competing *execution venues* is not intended to require a *firm* to compare the results that would be achieved for its *client* on the basis of its own execution policy and its own commissions and fees, with results that might be achieved for the same *client* by any other *firm* on the basis of a different execution policy or a different structure of commissions or fees. Nor is it intended to require a *firm* to compare the differences in its own commissions which are attributable to differences in the nature of the services that the *firm* provides to *clients*.

[**Note:** recital 93 to *MiFID*]

#### Information to clients

- 11.2A.50 R Following the execution of a transaction on behalf of a *client* a *firm*, other than a *management company* providing *collective portfolio management services*, must inform the *client* of where the order was executed.

[**Note:** article 27(3) of *MiFID*]

- 11.2A.51 G *Execution venues* (other than *market makers* and other liquidity providers to which *COBS 11.2B* applies) are reminded of the need to comply with the following provisions of *MAR*:

- (1) *MAR 5.3.1A R(5)*;
- (2) *MAR 5A.4.2R(3)*; and
- (3) *MAR 6.3A.1R*.

- 11.2A.52 R In accordance with the requirements of *COBS 11 Annex 1EU*, a *firm* which executes *client* orders must summarise and make public on an annual basis, for each class of *financial instruments*, the top five *execution venues* in terms of trading volumes, where they executed *client* orders in the preceding year, together with information on the quality of execution obtained.

[**Note:** article 27(6) of *MiFID*]

#### Transposition of best execution provisions in the UCITS implementing Directive

- 11.2A.53 G (1) This section applies to a *UCITS management company* as a result of *COBS 18.5B*.
- (2) Except where expressly modified (see *COBS 11.2A.2R(3)*), the provisions of the *MiFID Org Regulation* reproduced in this section apply to a *UCITS management company* as a result of *COBS*

11.2A.2R.

- (3) Some of these provisions have been used to transpose provisions of the *UCITS implementing Directive*, as set out in the table below:

<b>MiFID Org Regulation provision</b>	<b>COBS 11.2A reference</b>	<b>UCITS implementing Directive transposition</b>
article 64(1b)	11.2A.8EU	article 25(2b)
article 64(1c)	11.2A.8EU	article 25(2c)
article 64(1d)	11.2A.8EU	article 25(2d)
article 65(1)	11.2A.25EU	article 26(1)
article 65(4), first paragraph	11.2A.25EU	article 26(2) first paragraph
article 65(5)	11.2A.25EU	article 26(2) second paragraph, first three sentences.
article 65(6), as modified by COBS 11.2A.26R(2)	11.2A.25EU	article 26(2) second paragraph, final sentence.
article 65(7) first paragraph	11.2A.25EU	article 26(3) first paragraph
article 65(7) second and third paragraphs	11.2A.25EU	article 26(3) second paragraph

## 11.2B Quality of execution

- 11.2B.1 R *A market maker* or other liquidity provider must make available the data detailed in *COBS 11.2B.2R* to the public in the following manner:
- (1) at least on an annual basis; and
  - (2) without any charges.
- 11.2B.2 R *COBS 11.2B.1R* applies to data relating to the quality of execution of transactions by that *market maker* or other liquidity provider, including details about price, costs, speed and likelihood of execution for individual *financial instruments*.

[Note: article 27(3) of *MiFID*]

Amend the following as shown.

### 11.3 Client Order Handling

#### General Principles

- 11.3.1 R (1) *A firm (other than a management company providing collective portfolio management services) which is authorised to execute orders on behalf of clients must implement procedures and arrangements which provide for the prompt, fair and expeditious execution of client orders, relative to other orders or the trading interests of the firm.*

[Note: paragraph 1 of article ~~22(4)~~ 28(1) of *MiFID*]

- (2) These procedures or arrangements must allow for the execution of otherwise comparable orders in accordance with the time of their reception by the *firm*.

[Note: paragraph 2 of article ~~22(4)~~ 28(1) of *MiFID*]

- (3) *A management company providing collective portfolio management services, must establish and implement procedures and arrangements in respect of all client orders it carries out which provide for the prompt, fair and expeditious execution of portfolio transactions on behalf of the UCITS scheme or EEA UCITS scheme it manages.*

[Note: article 27(1) first paragraph of the *UCITS implementing Directive*]

- 11.3.1A R (1) This chapter contains a number of provisions marked with the status letters “EU” which have been selectively reproduced from the *MiFID Org Regulation*.
- (2) Where this chapter reproduces provisions of the *MiFID Org Regulation* they are directly applicable to *MiFID Org Regulation firms* in relation to their *MiFID business*. Such *firms* should use the Official Journal of the European Union for a comprehensive statement of their obligations under the *MiFID Org Regulation*.
- (3) The purpose of *COBS* 11.3.1BR is that these provisions are also applied in relation to other business and to other *firms* to which this chapter applies, as stated in that *rule*.
- 11.3.1B R (1) Subject to (2), (3) and (4) in this chapter provisions marked “EU” apply to a *firm’s* business other than *MiFID business* as if they were *rules*.

- (2) Any references within those provisions marked “EU” to other provisions of EU law must be interpreted in light of the purpose of this rule.
- (3) Provisions marked “EU” which derive from recitals to MiFID or the MiFID Org Regulation apply to all firms as guidance.
- (4) COBS 11.3.4AEU, which reproduces article 67(2) of the MiFID Org Regulation, does not apply to a management company.
- 11.3.1C     G     (1) COBS 11.3.1BR(2) has the effect that where a reproduced provision of an article of the MiFID Org Regulation includes a reference or cross reference to another part of the MiFID Org Regulation, that reference or cross reference is given the same meaning for the purposes of COBS 11.3.1BR.
- (2) Firms subject to COBS 11.3.1BR should use the text of the preamble to any relevant provision marked “EU” in order to interpret any such references or cross-references.
- 11.3.2     R     ~~A firm must satisfy the following conditions when carrying out client orders:~~
- (1) ~~it must ensure that orders executed on behalf of clients are promptly and accurately recorded and allocated;~~
- (2) ~~it must carry out otherwise comparable orders sequentially and promptly unless the characteristics of the order or prevailing market conditions make this impracticable, or the interests of the client require otherwise; and~~
- (3) ~~it must inform a retail client about any material difficulty relevant to the proper carrying out of orders promptly upon becoming aware of the difficulty. [deleted]~~
- ~~[Note: article 47(1) of the MiFID implementing Directive, article 19(1) of MiFID and article 27(1) second paragraph of the UCITS implementing Directive]~~
- 11.3.2A     EU     Article 67(1) of the MiFID Org Regulation requires firms to satisfy conditions when carrying out client orders.
- 67     (1) Investment firms shall satisfy the following conditions when carrying out client orders:
- (a) ensure that orders executed on behalf of clients are promptly and accurately recorded and allocated;
- (b) carry out otherwise comparable client orders sequentially and promptly unless the characteristics of the order or prevailing market conditions make this

impracticable, or the interests of the client require otherwise;

- (c) inform a retail client about any material difficulty relevant to the proper carrying out of orders promptly upon becoming aware of the difficulty.

11.3.3 G For the purposes of the provisions of this section, orders should not be treated as otherwise comparable if they are received by different media and it would not be practicable for them to be treated sequentially.

[**Note:** recital 78 110 to the *MiFID implementing Directive Org Regulation*]

11.3.4 R Where a *firm* is responsible for overseeing or arranging the settlement of an executed order or *management company* executes the order itself in the course of providing *collective portfolio management* services, it must take all reasonable steps to ensure that any *client financial instruments* or *client funds* received in settlement of that executed order are promptly and correctly delivered to the account of the appropriate *client UCITS scheme*.

[**Note:** article 47(2) of the *MiFID implementing Directive*, article 19(1) of *MiFID* and article 27(1) third paragraph of the *UCITS implementing Directive*]

11.3.4A EU Article 67(2) of the *MiFID Org Regulation* places requirements on *firms* which are responsible for overseeing and arranging the settlement of an executed order.

67 (2) Where an investment firm is responsible for overseeing or arranging the settlement of an executed order, it shall take all reasonable steps to ensure that any client financial instruments or client funds received in settlement of that executed order are promptly and correctly delivered to the account of the appropriate client.

11.3.5 EU ~~A *firm* must not misuse information relating to pending *client* orders, and shall take all reasonable steps to prevent the misuse of such information by any of its *relevant persons*. [deleted]~~

[**Note:** article 47(3) of the *MiFID implementing Directive*, article 19(1) of *MiFID* and article 27(2) of the *UCITS implementing Directive*]

11.3.5A EU Article 67(3) of the *MiFID Org Regulation* sets out requirements concerning the use of information relating to pending *client* orders.

67 (3) An investment firm shall not misuse information relating to pending *client* orders, and shall take all reasonable steps to prevent the misuse of such information by any of its *relevant persons*.



- 11.3.6 G Without prejudice to the *Market Abuse Regulation*, for the purposes of the *rule* on the misuse of information (see *COBS 11.3.5R*), any use by a *firm* of information relating to a pending *client* order in order to deal on own account in the *financial instruments* to which the *client* order relates, or in related *financial instruments*, should be considered a misuse of that information. However, the mere fact that *market makers* or bodies authorised to act as counterparties confine themselves to pursuing their legitimate business of buying and selling *financial instruments*, or that persons authorised to execute orders on behalf of third parties confine themselves to carrying out an order dutifully, should not in itself be deemed to constitute a misuse of information.

[**Note:** recital 78 110 to the *MiFID implementing Directive Org Regulation*]

#### Aggregation and allocation of orders

- 11.3.7 R ~~A *firm* is not permitted to carry out a *client* order or a transaction for own account in aggregation with another *client* order unless the following conditions are met:~~
- ~~(1) it must be unlikely that the aggregation of orders and transactions will work overall to the disadvantage of any *client* whose order is to be aggregated;~~
  - ~~(2) it must be disclosed to each *client* whose order is to be aggregated that the effect of aggregation may work to its disadvantage in relation to a particular order;~~
  - ~~(3) an order allocation policy must be established and effectively implemented, providing in sufficiently precise terms for the fair allocation of aggregated orders and transactions, including how the volume and price of orders determines allocations and the treatment of partial executions. [deleted]~~

[**Note:** article 48(1) of the *MiFID implementing Directive*, article 19(1) of *MiFID* and article 28(1) of the *UCITS implementing Directive*]

- 11.3.7A EU Article 68(1) of the *MiFID Org Regulation* sets out requirements to be met where a *firm* carries out a *client* order or a transaction for own account in aggregation with another *client* order.

- 68 (1) Investment firms shall not carry out a *client* order or a transaction for own account in aggregation with another *client* order unless the following conditions are met:
- (a) it is unlikely that the aggregation of orders and transactions will work overall to the disadvantage of any *client* whose orders is to be aggregated;
  - (b) it is disclosed to each *client* whose order is to be

aggregated that the effect of aggregation may work to its disadvantage in relation to a particular order;

- (c) an order allocation policy is established and effectively implemented, providing for the fair allocation of aggregated orders and transactions, including how the volume and price of orders determines allocations and the treatment of partial executions.

11.3.7B R A management company must ensure that the order allocation policy referred to in article 68(1)(c) of the MiFID Org Regulation, reproduced at COBS 11.3.7AEU, is in sufficiently precise terms.

[Note: article 28(1) of the UCITS implementing Directive]

~~11.3.8 R If a firm aggregates a client order with one or more other orders and the aggregated order is partially executed, it must allocate the related trades in accordance with its order allocation policy. [deleted]~~

~~[Note: article 48(2) of the MiFID implementing Directive, article 19(1) of MiFID and article 28(2) of the UCITS implementing Directive]~~

11.3.8A EU Article 68(2) of the MiFID Org Regulation sets out requirements concerning partial execution of aggregated client orders.

68 (2) Where an investment firm aggregates an order with one or more other client orders and the aggregated order is partially executed, it shall allocate the related trades in accordance with its order allocation policy.

Aggregation and allocation of transactions for own account

~~11.3.9 R A firm which has aggregated transactions for own account with one or more client orders must not allocate the related trades in a way which is detrimental to a client. [deleted]~~

~~[Note: article 49(1) of the MiFID implementing Directive, article 19(1) of MiFID and article 28(3) of the UCITS implementing Directive]~~

11.3.9A EU Article 69(1) of the MiFID Org Regulation sets out requirements concerning aggregated transactions.

69 (1) Investment firms which have aggregated transactions for own account with one or more client orders shall not allocate the related trades in a way that is detrimental to a client.

~~11.3.10 R (1) If a firm aggregates a client order with a transaction for own account and the aggregated order is partially executed, it must allocate the related trades to the client in priority to the firm.~~

- (2) ~~However, if the *firm* is able to demonstrate on reasonable grounds that without the combination it would not have been able to carry out the order on such advantageous terms, or at all, it may allocate the transaction for own account proportionally, in accordance with its order allocation policy. [deleted]~~

~~[Note: article 49(2) of the *MiFID implementing Directive*, article 19(1) of *MiFID* and article 28(4) of the *UCITS implementing Directive*]~~

- 11.3.10A EU Article 69(2) of the *MiFID Org Regulation* sets out allocation priorities where a *firm* aggregates a *client* order in accordance with its allocation policy referred to in article 68(1)(c) (see *COBS 11.3.7A*).

69 (2) Where an investment firm aggregates a client order with a transaction for own account and the aggregated order is partially executed, it shall allocate the related trades to the client in priority to the firm.

Where an investment firm is able to demonstrate on reasonable grounds that without the combination it would not have been able to carry out the order on such advantageous terms, or at all, it may allocate the transaction for own account proportionally, in accordance with its order allocation policy referred to in Article 68(1)(c).

- 11.3.11 R ~~A *firm* must, as part of its order allocation policy, put in place procedures to prevent the reallocation, in a way that is detrimental to the *client*, of transactions for own account which are executed in combination with *client* orders. [deleted]~~

~~[Note: article 49(3) of the *MiFID implementing Directive* and article 19(1) of *MiFID*]~~

- 11.3.11A EU Article 69(3) of the *MiFID Org Regulation* introduces requirements for order allocation policy, referred to in article 68(1)(c) (see *COBS 11.3.7A*), where transactions for own account are executed in combination with *client* orders.

69 (3) As part of the order allocation policy referred to in Article 68(1)(c), investment firms shall put in place procedures designed to prevent the reallocation, in a way that is detrimental to the client, of transactions for own account which are executed in combination with client orders.

- 11.3.12 G For the purposes of the provisions of this section, the reallocation of transactions should be considered as detrimental to a *client* if, as an effect of that reallocation, unfair precedence is given to the *firm* or to any particular *person*.

~~[Note: recital 77 109 to the *MiFID implementing Directive Org Regulation*]~~

- 11.3.13 G In this section, carrying out *client* orders includes:
- (1) the *execution of orders on behalf of clients*;
  - (2) the placing of orders with other entities for execution that result from decisions to deal in *financial instruments* on behalf of *clients* when providing the service of *portfolio management* or *collective portfolio management*;
  - (3) the transmission of *client* orders to other entities for execution when providing the service of reception and transmission of orders.

Transposition of client order handling provisions in the UCITS Implementing Directive

- 11.3.14 G (1) This section applies to a *UCITS management company* as a result of *COBS 18.5B.2R*.
- (2) The provisions of the *MiFID Org Regulation* reproduced in this section apply to a *UCITS management company* as a result of *COBS 11.3.1BR*.
- (3) Some of these provisions have been used to transpose provisions of the *UCITS implementing Directive*, as set out in the table below:

<u>MiFID Org Regulation Provision</u>	<u>COBS 11.3 provision</u>	<u>UCITS implementing Directive transposition</u>
<u>article 67(1)</u>	<u>COBS 11.3.2AEU</u>	<u>article 27(1) second paragraph</u>
<u>article 67(3)</u>	<u>COBS 11.3.5AEU</u>	<u>article 27(2)</u>
<u>article 68(1)</u>	<u>COBS 11.3.7AEU, as modified by COBS 11.3.7BR</u>	<u>article 28(1)</u>
<u>article 68(2)</u>	<u>COBS 11.3.8AEU</u>	<u>article 28(2)</u>
<u>article 69(1)</u>	<u>COBS 11.3.9AEU</u>	<u>article 28(3)</u>
<u>article 69(2)</u>	<u>COBS 11.3.10AEU</u>	<u>article 28(4)</u>

## 11.4 Client Limit Orders

- 11.4.-3 R (1) This chapter contains a number of provisions marked with the status letters “EU” which have been selectively reproduced from the *MiFID Org Regulation*.

- (2) Where this chapter reproduces provisions of the *MiFID Org Regulation* they are directly applicable to *MiFID Org Regulation firms* in relation to their *MiFID business*. Such *firms* should use the Official Journal of the European Union for a comprehensive statement of their obligations under the *MiFID Org Regulation*.
- (3) The purpose of COBS 11.4.-2R is that these provisions are also applied in relation to other business and to other *firms* to which this chapter applies, as stated in that *rule*.
- 11.4.-2 R (1) Subject to (2), in this chapter provisions marked “EU” apply to a *firm’s* business other than *MiFID business* as if they were *rules*.
- (2) Any references within those provisions marked “EU” to other provisions of *EU* law must be interpreted in light of the purpose of this *rule*.
- 11.4.-1 G (1) COBS 11.4.-2R(2) has the effect that where a reproduced provision of an article of the *MiFID Org Regulation* includes a reference or cross reference to another part of the *MiFID Org Regulation*, that reference or cross reference is given the same meaning for the purposes of COBS 11.4.-2R.
- (2) *Firms* subject to COBS 11.4.-2R(2) should use the text of the preamble to any relevant provision marked “EU” in order to interpret any such references or cross-references.

#### Obligation to make unexecuted client limit orders public

- 11.4.1 R Unless a *client* expressly instructs otherwise, a *firm* must, in the case of a *client limit order* in respect of shares admitted to trading on a *regulated market* or traded on a *trading venue* which is not immediately executed under prevailing market conditions, take measures to facilitate the earliest possible execution of that order by making public immediately that *client limit order* in a manner which is easily accessible to other market participants.

[Note: article 22 28(2) of *MiFID*]

- 11.4.2 G In respect of transactions executed between *eligible counterparties*, the obligation to disclose *client limit orders* should only apply where the counterparty is explicitly sending a *limit order* to a *firm* for its execution.

[Note: recital 42 105 to *MiFID*]

#### How client limit orders may be made public

- 11.4.3 EU ~~An *investment firm* shall be considered to disclose *client limit orders* that are not immediately executable if it transmits the order to a *regulated market* or *MTF* that operates an order book trading system, or ensures that the order is made public and can be easily executed as soon as market~~

~~conditions allow. [deleted]~~

~~[Note: article 31 of MiFID Regulation]~~

11.4.3A    EU    Article 70(1) of the MiFID Org Regulation provides when client limit orders shall be considered as being available to the public.

70        (1)        A client limit order in respect of shares admitted to trading on a regulated market or traded on a trading venue which have not been immediately executed under prevailing market condition as referred to in Article 28(2) of Directive 2014/65/EU shall be considered available to the public when the investment firm has been submitted the order for execution to a regulated market or a MTF or the order has been published by a data reporting services provider located in one Member State and can be easily executed as soon as market conditions allow.

11.4.4        G        ~~MAR 5.8.2EU sets out the conditions required for an arrangement to make client limit orders public under this section. MAR 5.8.3G and MAR 5.8.4G provide guidance on these conditions. [deleted]~~

11.4.4A        G        Firms may comply with the obligations in COBS 11.4.1R, to make public unexecuted client limit orders, by transmitting the client limit order to a trading venue.

~~[Note: article 28(2) of MiFID]~~

Orders that are large in scale

11.4.5        R        ~~The obligation in COBS 11.4.1R to make public a limit order will not apply to a limit order that is~~ is disapplied in respect of transactions that are large in scale compared with normal market size as determined under article 4 of MiFIR.

~~[Note: article 22 28(2) of MiFID]~~

11.4.6        G        ~~MAR 5.7.10EU and MAR 5.7.11EU set out when an order shall be considered large in scale compared with normal market size. [deleted]~~

## **11.5        Record Keeping: client orders and transactions [deleted]**

COBS 11.5 is deleted in its entirety. The deleted text is not shown.

Insert the new chapter 11.5A after the deleted COBS 11.5 (Record Keeping: client orders and transactions). All the text is new and is not underlined.

**11.5A Record keeping: client orders and transactions**

- 11.5A.1 G (1) This chapter contains a number of provisions marked with the status letters “EU”, which have been selectively reproduced from the *MiFID Org Regulation*.
- (2) Where this chapter reproduces provisions of the *MiFID Org Regulation* they are directly applicable to *MiFID Org Regulation firms* in relation to their *MiFID business*. Such *firms* should use the Official Journal of the European Union for a comprehensive statement of their obligations under the *MiFID Org Regulation*.
- (3) The purpose of *COBS* 11.5A.2R is that these provisions are also applied in relation to other business and to other *firms* to which this chapter applies, as stated in that *rule*.
- 11.5A.2 R (1) Subject to (2), (3) and (4), in this chapter provisions marked “EU” apply to a *firm*’s business other than *MiFID business* as if they were *rules*.
- (2) Provisions in this chapter which are marked “EU” do not apply to *corporate finance business* carried on by a *firm* which is not a *MiFID investment firm*.
- (3) Any references within those provisions marked “EU” to other provisions of *EU* law must be interpreted in light of the purpose of this *rule*.
- 11.5A.3 G (1) *COBS* 11.5A.2R(3) has the effect that where a reproduced provision of an article of the *MiFID Org Regulation* includes a reference or cross reference to another part of the *MiFID Org Regulation*, that reference or cross reference is given the same meaning for the purposes of *COBS* 11.5A.2R.
- (2) *Firms* subject *COBS* 11.5A.2R should use the text of the preamble to any relevant provision marked “EU” in order to interpret any such references or cross-reference.
- 11.5A.4 EU Article 74 of the *MiFID Org Regulation*, together with Section 1 of Annex IV to that Regulation which is reproduced at *COBS* 11.5A.6EU, makes provision for record keeping of initial orders from *clients*.

74 An investment firm shall, in relation to every initial order received from a client and in relation to every initial decision to deal taken, immediately record and keep at the disposal of the competent authority at least the details set out in Section 1 of Annex IV [reproduced below at *COBS* 11.5A.6EU] to this Regulation to the extent they are applicable to the order or decision to deal in question.

Where the details set out in Section 1 of Annex IV to this Regulation are also prescribed under Articles 25 and 26 of

Regulation No (EU) 600/2014, these details should be maintained in a consistent way and according to the same standards prescribed under Articles 25 and 26 of Regulation No (EU) 600/2014.

- 11.5A.5 EU Article 75 of the *MiFID Org Regulation*, together with Section 2 of Annex IV to that Regulation which is reproduced at *COBS 11.5A.7EU*, makes provision for record keeping in relation to transactions and order processing.

75 Investment firms shall, immediately after receiving a client order or making a decision to deal to the extent they are applicable to the order or decision to deal in question, record and keep at the disposal of the competent authority at least the details set out in Section 2 of Annex IV [reproduced below at *COBS 11.5A.7EU*].

Where the details set out in Section 2 of Annex IV are also prescribed under Articles 25 and 26 of Regulation No (EU) 600/2014, they shall be maintained in a consistent way and according to the same standards prescribed under Articles 25 and 26 of Regulation (EU) No 600/2014.

- 11.5A.6 EU Annex IV Section 1 of the *MiFID Org Regulation* makes provision for record keeping of *client* orders and decisions to deal.

1. Name and designation of the client
2. Name and designation of any relevant person acting on behalf of the client
3. A designation to identify the trader (Trader ID) responsible within the investment firm for the investment decision
4. A designation to identify the algorithm (Algo ID) responsible within the investment firm for the investment decision;
5. B/S indicator;
6. Instrument identification
7. Unit price and price notation
8. Price
9. Price multiplier
10. Currency 1
11. Currency 2
12. Initial quantity and quantity notation
13. Validity period



14. Type of the order
15. Any other details, conditions and particular instructions from the client
16. The date and exact time of the receipt of the order or the date and exact time of when the decision to deal was made. The exact time must be measured according to the methodology prescribed under the standards on clock synchronisation under Article 50(2) Directive 2014/65/EU.

11.5A.7 EU Annex IV Section 2 of the *MiFID Org Regulation* makes provision for record keeping of transactions and order processing.

1. Name and designation of the client
2. Name and designation of any relevant person acting on behalf of the client
3. A designation to identify the trader (Trader ID) responsible within the investment firm for the investment decision
4. A designation to identify the Algo (Algo ID) responsible within the investment firm for the investment decision
5. Transaction reference number
6. A designation to identify the order (Order ID)
7. The identification code of the order assigned by the trading venue upon receipt of the order
8. A unique identification for each group of aggregated clients' orders (which will be subsequently placed as one block order on a given trading venue). This identification should be indicated "aggregated\_X" with X representing the number of clients whose orders have been aggregated
9. The segment MIC code of the trading venue to which the order has been submitted
10. The name and other designation of the person to whom the order was transmitted
11. Designation to identify the Seller & the Buyer
12. The trading capacity
13. A designation to identify the Trader (Trader ID) responsible for the execution

14. A designation to identify the Algo (Algo ID) responsible for the execution
15. B/S indicator;
16. Instrument identification
17. Ultimate underlying
18. Put/Call identifier
19. Strike price
20. Upfront payment
21. Delivery type
22. Option style
23. Maturity date
24. Unit price and price notation
25. Price
26. Price multiplier
27. Currency 1
28. Currency 2
29. Remaining quantity
30. Modified quantity
31. Executed quantity
32. The date and exact time of submission of the order or decision to deal. The exact time must be measured according to the methodology prescribed under the standards on clock synchronisation under Article 50(2) of Directive 2014/65/EU.
33. The date and exact time of any message that is transmitted to and received from the trading venue in relation to any events affecting an order. The exact time must be measured according to the methodology prescribed under the RTS on clock synchronisation.
34. The date and exact time any message that is transmitted to and received from another investment firm in relation to any events affecting an order. The exact time must be measured according to the methodology prescribed under the standards on clock synchronisation under Article 50(2) of Directive 2014/65/EU.

- 35. Any message that is transmitted to and received from the trading venue in relation to orders placed by the investment firm
- 36. Any other details and conditions that was submitted to and received from another investment firm in relation with the order
- 37. Each placed order's sequences in order to reflect the chronology of every event affecting it, including but not limited to modifications, cancellations and execution
- 38. Short selling flag
- 39. SSR exemption flag
- 40. Waiver flag

COBS 11.6 (Use of dealing commission) is deleted in its entirety and the deleted text is not shown.

...

## 11.7 Personal account dealing

### Application

11.7.-1 R This section does not apply to a *firm* in relation to *MiFID, equivalent third country or optional exemption business* (but see *COBS 11.7A (Personal account dealing relating to MiFID, equivalent third country or optional exemption business)*).

Rule on personal account dealing

11.7.1 R A *firm* that conducts *designated investment business* must establish, implement and maintain adequate arrangements aimed at preventing the following activities in the case of any *relevant person* who is involved in activities that may give rise to a conflict of interest, or who has access to inside information as defined in the *Market Abuse Regulation* or to other confidential information relating to *clients* or transactions with or for *clients* by virtue of an activity carried out by him on behalf of the *firm*:

- (1) ...
- ...
- (3) disclosing, other than in the normal course of his or her 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 disclosure that other *person* will or would be

likely to take either of the following steps:

- (a) to enter into a transaction in ~~designated investments~~ *designated investments* which, if a personal transaction of the relevant person, would be covered by (1) or a relevant provision;
- (b) to advise or procure another *person* to enter into such a transaction.

[~~Note: article 12(1) of MiFID implementing Directive and~~ article 13(1) of the *UCITS implementing Directive*]

11.7.2 R For the purposes of this section, the relevant provisions are:

- (1) ~~the rules~~ article 37(2)(a) and (b) of the *MiFID Org Regulation* on *personal transactions* undertaken by *financial analysts* ~~in COBS 12.2.5 R (1) and (2)~~ copied out in COBS 12.2.21EU which apply as rules as a result of COBS 12.2.15R;
- (2) ~~the rule~~ article 67(3) of the *MiFID Org Regulation* on the misuse of information relating to pending *client* orders ~~in COBS 11.3.5R~~ copied out in COBS 11.3.5AEU which applies as a rule as a result of COBS 11.3.1BR.

...

11.7.4 R The arrangements required under this section must in particular be designed to ensure that:

- (1) ...

[~~Note: article 12(2) of MiFID implementing Directive and~~ article 13(2) of the *UCITS implementing Directive*]

Disapplication of rule on personal account dealing

11.7.5 R This section does not apply to the following kinds of *personal transaction*:

- (1) ...

[~~Note: article 12(3) of MiFID implementing Directive and~~ article 13(3) of the *UCITS implementing Directive*]

...

Successive personal transactions

11.7.7 R Where successive *personal transactions* are carried out on behalf of a *person* in accordance with prior instructions given by that *person*, the obligations under this section do not apply:

(1) ...

~~[Note: recital 17 to *MiFID implementing Directive*]~~

Insert the new *COBS* 11.7A after *COBS* 11.7 (Personal account dealing). All of the text is new and is not underlined.

**11.7A Personal account dealing relating to MiFID, equivalent third country or optional exemption business**

Application

- 11.7A.1 R This chapter applies to a *firm* in relation to its *MiFID, equivalent third country or optional exemption business*.
- 11.7A.2 G (1) This chapter contains a number of provisions marked with the status letters “EU”, which have been selectively reproduced from the *MiFID Org Regulation*.
- (2) Where this chapter reproduces provisions of the *MiFID Org Regulation* (see the preamble set out above the reproduced provision), they are directly applicable to *MiFID Org Regulation firms* in relation to their *MiFID business*. Such *firms* should use the Official Journal of the European Union for a comprehensive statement of their obligations under the *MiFID Org Regulation*.
- (3) The purpose of *COBS* 11.7A.3R is that these provisions are also applied to a *firm* in relation to its *equivalent third country or optional exemption business*.
- 11.7A.3 R (1) Subject to (2) and (3), in this chapter provisions marked “EU” apply to a *firm* in relation to its *equivalent third country or optional exemption business* as if they were *rules*.
- (2) Any references within those provisions marked “EU” to other provisions of *EU* law must be interpreted in light of the purpose of the *rule*.
- (3) In this chapter, provisions marked “EU” which derive from recitals to *MiFID* or the *MiFID Org Regulation* apply to a *firm* in relation to its *equivalent third country or optional exemption business* as *guidance*.
- 11.7A.4 G (1) *COBS* 11.7A.3R(2) has the effect that where a reproduced provision of an article of the *MiFID Org Regulation* includes a reference or cross reference to another part of the *MiFID Org Regulation*, that reference or cross reference is given the same meaning for the purposes of *COBS* 11.7A.3R.

- (2) *Firms* subject to *COBS* 11.7A.3R should use the text of the preamble to any relevant procession marked “EU” in order to interpret any such references or cross-reference.

11.7A.5 R A *firm* that conducts *designated investment business* must establish appropriate rules governing personal transactions undertaken by managers, employees and *tied agents*.

[**Note:** article 16(2) of *MiFID*]

Scope of personal transactions

11.7A.6 EU Article 28 of the *MiFID Org Regulation* sets out the scope of personal transactions.

28 For the purposes of the Article 29 and Article 37, a personal transaction be a trade in a financial instrument effected by or on behalf of a relevant person, where at least one of the following criteria are met:

- (a) the relevant person is acting outside the scope of the activities he carries out in this professional capacity;
- (b) the trade is carried out for the account of any of the following persons:
  - (i) the relevant person;
  - (ii) any person with who he has a family relationship, or with whom he has close links;
  - (iii) a person in respect of whom the relevant person has a direct or indirect material interest in the outcome of the trade, other than obtaining a fee or commission for the execution of the trade.

11.7A.7 EU Article 29 of the *MiFID Org Regulation* sets out detailed provision concerning personal transactions.

29 (1) Investment firms shall establish, implement and maintain adequate arrangements aimed at preventing the activities set out in paragraphs 2 and 3 in the case of any relevant person who is involved in activities that may give rise to a conflict of interest, or who has access to inside information within the meaning of Article 7(1) of Regulation (EU) No 596/2014 or to other confidential information relating to clients or transactions with of for clients by virtue of an activity carried out by him on behalf of the firm.

(2) Investment firms shall not enter into a personal transaction which meets at least one of the following criteria:

- (a) that person is prohibited from entering into it under Regulation (EU) No 596/2014;
  - (b) it involves the misuse or improper disclosure of that confidential information;
  - (c) it conflicts or is likely to conflict with an obligation of the investment firm under Directive 2014/65/EU.
- (3) Investment firms shall not advise or recommend, other than in the proper course of employment or contract for services, any other person to enter into a transaction in financial instruments which, if it were a personal transaction or the relevant person, would be covered by point (a) or Article 37(2)(a) or (b) or Article 63(3);
- (4) Without prejudice to Article 10 (1) of Regulation (EU) No 596/2014, disclosing, other than in the normal course of his employment or contract for services, any information or opinion to any other person where the relevant person knows, or reasonably ought to know, that as a result of that disclosure that other person will or would be likely to take either of the following steps:
- (a) to enter into a transaction in financial instruments which, if it were a personal transaction of the relevant person, would be covered by point (a) or Article 37(2)(a) or (b) or Article 63(3);
  - (b) to advise or procure another person to enter into such a transaction.
- (5) The arrangements required under paragraph 1 shall be designed to ensure that:
- (a) each relevant person covered by paragraphs 1 and 2 is aware of the restrictions on personal transactions, and of the measures established by the investment firms in connection with personal transactions and disclosure, in accordance with paragraphs 1 and 2;
  - (b) the firm is informed promptly of any personal transaction entered into by a relevant person, either by notification of that transaction or by other procedures enabling the firm to identify such transactions;
  - (c) a record is kept of the personal transaction notified to the firm of identified by it, including any authorisation or prohibition in connection with such a transaction.

In the case of outsourcing arrangements, the investment firm shall ensure that the firm to which the activity is outsourced maintains a record of personal transactions entered into by any relevant person and provides that information to the investment firm promptly on request.

- (6) Paragraphs 1 to 5 shall not apply to the following personal transactions:
- (a) 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;
  - (b) personal transactions in undertakings for collective investments in transferable securities (UCITS) or AIFs that are subject to supervision under the law of a Member State which requires 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.

- 11.7A.8 R (1) Where successive *personal transactions* are carried out on behalf of a *person* in accordance with prior instructions given by that *person*, the obligations under this section do not apply:
- (a) separately to each successive transaction if those instructions remain in force and unchanged; or
  - (b) to the termination or withdrawal of such instructions, provided that any *financial instruments* which had previously been acquired pursuant to the instructions are not disposed of at the same time as the instructions terminate or are withdrawn.
- (2) Obligations under this section do apply in relation to a *personal transaction*, or the commencement of successive *personal transactions*, that are carried out on behalf of the same *person* if those instructions are changed or if new instructions are issued.

[**Note:** recital 42 to the *MiFID Org Regulation*]

...

COBS 11.8 (Recording telephone conversations and electronic communications) is deleted in its entirety. The deleted text is not shown.



**11.8 Recording telephone conversations and electronic communications [deleted]**

Insert new COBS 11 Annex 1EU after COBS 11.8 (Recording telephone conversations and electronic communications). The material in this Annex comprises the text of Regulatory Technical Standard 28 (C(2016) 3337) made under Directive 2014/65/EU (MiFID II) and the annexes to that text. The text is new and is not underlined.

**11 Annex Regulatory Technical Standard 28 (RTS 28)  
1EU****COMMISSION DELEGATED REGULATION (EU) .../... of 8.6.2016  
supplementing Directive 2014/65/EU of the European Parliament and of the  
Council with regard to regulatory technical standards for the annual  
publication by investment firms of information on the identity of execution  
venues and on the quality of execution (Text with EEA relevance)**

THE EUROPEAN COMMISSION,  
Having regard to the Treaty on the Functioning of the European Union,  
Having regard to Directive 2014/65/EU of the European Parliament and of the  
Council on markets in financial instruments and amending Directive 2004/92/EC  
and Directive 2011/61/EU (OJ L 173, 12.6.2014, p.349), and in particular point  
(b) of the first subparagraph of Article 27(10),

Whereas:

- (1) It is essential to enable the public and investors to evaluate the quality of an investment firm's execution practices and to identify the top five execution venues in terms of trading volumes where investment firms executed client orders in the preceding year. In order to make meaningful comparisons and analyse the choice of top five execution venues it is necessary that information is published by investment firms specifically in respect of each class of financial instruments. In order to be able to fully evaluate the order flow of client orders to execution venues, investors and the public should be able to clearly identify if the investment firm itself was one of the top five execution venues for each class of financial instrument.
- (2) In order to fully assess the extent of the quality of execution being obtained on execution venues used by investment firms to execute client orders, including execution venues in third countries, it is appropriate that investment firms publish information required under this Regulation in relation to trading venues, market makers or other liquidity providers or any entity that performs a similar function in a third country to the functions performed by any of the foregoing.
- (3) In order to provide precise and comparable information, it is necessary to set out classes of financial instruments based on their characteristics relevant for

publication purposes. A class of financial instruments should be narrow enough to reveal differences in order execution behaviour between classes but at the same time broad enough to ensure that the reporting obligation on investment firms is proportionate. Given the breadth of the equity class of financial instruments, it is appropriate to divide this class into subclasses based on liquidity. As liquidity is an essential factor governing execution behaviours and as execution venues are often competing to attract flows of the most frequently traded stocks, it is appropriate that equity instruments are classified according to their liquidity as determined under the tick size regime as set out in Directive 2014/65/EU of the European Parliament and the Council.

(4) When publishing the identity of the top five execution venues on which they execute client orders it is appropriate for investment firms to publish information on the volume and number of orders executed on each execution venue, so that investors may be able to form an opinion as to the flow of client orders from the firm to execution venue. Where, for one or several classes of financial instruments, an investment firm only executes a very small number of orders, information on the top five execution venues would not be very meaningful nor representative of order execution arrangements. It is therefore appropriate to require investment firms to clearly indicate the classes of financial instruments for which they execute a very small number of orders.

(5) To prevent potentially market sensitive disclosures on the volume of business being conducted by the investment firm, the volume of execution and the number of executed orders should be expressed as a percentage of the investment firm's total execution volumes and total number of executed orders in that class of financial instrument, respectively, rather than as absolute values.

(6) It is appropriate to require investment firms to publish information which is relevant to their order execution behaviour. To ensure that investment firms are not held accountable for order execution decisions for which they are not responsible, it is appropriate for investment firms to disclose the percentage of orders executed on each of the top five execution venues where the choice of execution venue has been specified by clients.

(7) There are several factors which may potentially influence the order execution behaviour of investment firms such as close links between investment firms and execution venues. Given the potential materiality of these factors it is appropriate to require analysis of such factors in assessing the quality of execution obtained on all execution venues.

(8) The different order types can be an important factor in explaining how and why investment firms execute orders on a given execution venue. It may also impact the way an investment firm will set its execution strategies, including programming of smart order routers to meet the specific objectives of those orders. It is therefore appropriate that a distinction between the different categories of order types be clearly marked in the report.

(9) In order to properly analyse information it is important that users are in a position to differentiate between execution venues used for professional client orders and execution venues used for retail client orders, given the notable

differences in how investment firms obtain the best possible result for retail clients as compared to professional clients, namely that investment firms must predominantly assess the factors of price and cost when executing orders from retail clients. Therefore it is appropriate that information on the top five execution venues be provided separately for retail clients and for professional clients respectively, permitting a qualitative assessment to be made of the order flow to such venues.

(10) In order to comply with the legal obligation of best execution, investment firms, when applying the criteria for best execution for professional clients, will typically not use the same execution venues for securities financing transactions (SFTs) and other transactions. This is because the SFTs are used as a source of funding subject to a commitment that the borrower will return equivalent securities on a future date and the terms of SFTs are typically defined bilaterally between the counterparties ahead of the execution. Therefore, the choice of execution venues for SFTs is more limited than in the case of other transactions, given that it depends on the particular terms defined in advance between the counterparties and on whether there is a specific demand on those execution venues for the financial instruments involved. It is therefore appropriate that investment firms summarise and make public the top five execution venues in terms of trading volumes where they executed SFTs in a separate report so that that a qualitative assessment can be made of the order flow to such venues. Due to the specific nature of SFTs, and given that their large size would likely distort the more representative set of client transactions (namely, those not involving SFTs), it is also necessary to exclude them from the tables concerning the top five execution venues on which investment firms execute other client orders.

(11) It is appropriate that investment firms should publish an assessment of quality of execution obtained on all venues used by the firm. This information will provide a clear picture of the execution strategies and tools used to assess the quality of execution obtained on those venues. This information will also allow investors to assess the effectiveness of the monitoring carried out by investment firms in relation to those execution venues.

(12) In specifically assessing the quality of execution obtained on all execution venues in relation to cost, it is appropriate that an investment firm also performs an analysis of the arrangements it has with these venues in relation to payments made or received and to discounts, rebates or non-monetary benefits received. Such an assessment should also allow the public to consider how such arrangements impact the costs faced by the investor and how they comply with Article 27(2) of Directive 2004/65/EC.

(13) It is also appropriate to determine the scope of such publication and its essential features, including the use that investment firms make of the data on execution quality available from execution venues under Commission Delegated Regulation (EU) .../... (Commission Delegated Regulation (EU) .../... supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards concerning the data to be published by execution venues on the quality of execution of transactions (OJ L.....).

(14) Information on identity of execution venues and on the quality of execution should be published annually and should refer to order execution behaviour for each class of financial instruments in order to capture relevant changes within the preceding calendar year.

(15) Investment firms should not be prevented from adopting an additional level of reporting which is more granular, provided that in such case the additional report complements and does not replace what is required under this Regulation.

(16) For reasons of consistency and in order to ensure the smooth functioning of the financial markets, it is necessary that the provisions laid down in this Regulation and the related national provisions transposing Directive 2014/65/EU apply from the same date.

(17) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the Commission.

(18) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council (Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84)).

HAS ADOPTED THIS REGULATION:

*Article 1 Subject matter*

**This Regulation lays down rules on the content and the format of information to be published by investment firms on an annual basis in relation to client orders executed on trading venues, systematic internalisers, market makers or other liquidity providers or entities that perform a similar function to those performed by any of the foregoing in a third country.**

*Article 2 Definitions*

**(a) ‘Passive order’ means an order entered into the order book that provided liquidity;**

**(b) ‘Aggressive order’ means an order entered into the order book that took liquidity;**

**(c) ‘Directed order’ means an order where a specific execution venue was specified by the client prior to the execution of the order.**

*Article 3 Information on the top five execution venues and quality of execution obtained*

**1. Investment firms shall publish the top five execution venues in terms of**

trading volumes for all executed client orders per class of financial instruments referred to in Annex I. Information regarding retail clients shall be published in the format set out in Table 1 of Annex II and information regarding professional clients shall be published in the format set out in Table 2 of Annex II. The publication shall exclude orders in Securities Financing Transactions (SFTs) and shall contain the following information:

- (a) class of financial instruments;
- (b) venue name and identifier;
- (c) volume of client orders executed on that execution venue expressed as a percentage of total executed volume;
- (d) number of client orders executed on that execution venue expressed as a percentage of total executed orders;
- (e) percentage of the executed orders referred to in point (d) that were passive and aggressive orders;
- (f) percentage of orders referred to in point (d) that were directed orders;
- (g) confirmation of whether it has executed an average of less than one trade per business day in the previous year in that class of financial instruments.

2. Investment firms shall publish the top five execution venues in terms of trading volumes for all executed client orders in SFTs for class of financial instruments referred to in Annex I in the format set out in Table 3 of Annex II. The publication shall contain the following information:

- (a) volume of client orders executed on that execution venue expressed as a percentage of total executed volume;
- (b) number of client orders executed on that execution venue expressed as a percentage of total executed orders;
- (c) confirmation of whether the investment firm has executed an average of less than one trade per business day in the previous year in that class of financial instruments.

3. Investment firms shall publish for each class of financial instruments, a summary of the analysis and conclusions they draw from their detailed monitoring of the quality of execution obtained on the execution venues where they executed all client orders in the previous year. The information shall include:

- (a) an explanation of the relative importance the firm gave to the execution factors of price, costs, speed, likelihood of execution or any other consideration including qualitative factors when assessing the quality of execution;
- (b) a description of any close links, conflicts of interests, and common ownerships with respect to any execution venues used to execute orders;
- (c) a description of any specific arrangements with any execution venues regarding payments made or received, discounts, rebates or non-monetary benefits received;
- (d) an explanation of the factors that led to a change in the list of execution

venues listed in the firm's execution policy, if such a change occurred;

(e) an explanation of how order execution differs according to client categorisation, where the firm treats categories of clients differently and where it may affect the order execution arrangements;

(f) an explanation of whether other criteria were given precedence over immediate price and cost when executing retail client orders and how these other criteria were instrumental in delivering the best possible result in terms of the total consideration to the client;

(g) an explanation of how the investment firm has used any data or tools relating to the quality of execution, including any data published under Commission Delegated Regulation (EU) .../...to be inserted before publication [RTS 27];

(h) where applicable, an explanation of how the investment firm has used output of a consolidated tape provider established under Article 65 of Directive 2014/65/EU.

*Article 4 Format*

Investment firms shall publish the information required in accordance with Article 3(1) and 3(2) on their websites, by filling in the templates set out in Annex II, in a machine-readable electronic format, available for downloading by the public and the information required in accordance with Article 3(3) shall be published on their websites in an electronic format available for downloading by the public.

*Article 5 Entry into force and application*

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

It shall apply from the date that appears first in the second subparagraph of Article 93(1) of Directive 2014/65/EU

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

Done at Brussels, 8.6.2016

*For the Commission*

*The President Jean-Claude JUNCKER*

ANNEXES to the COMMISSION DELEGATED REGULATION supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the annual publication by investment firms of information on the identity of execution venues and on the quality of execution

ANNEXES

**Annex I: Classes of financial instruments**

- (a) Equities – Shares & Depositary Receipts
  - (i) Tick size liquidity bands 5 and 6 (from 2000 trades per day)
  - (ii) Tick size liquidity bands 3 and 4 (from 80 to 1999 trades per day)
  - (iii) Tick size liquidity band 1 and 2 (from 0 to 79 trades per day)
- (b) Debt instruments
  - (i) Bonds
  - (ii) Money markets instruments
- (c) Interest rates derivatives
  - (i) Futures and options admitted to trading on a trading venue
  - (ii) Swaps, forwards, and other interest rates derivatives
- (d) credit derivatives
  - (i) Futures and options admitted to trading on a trading venue
  - (ii) Other credit derivatives
- (e) currency derivatives
  - (i) Futures and options admitted to trading on a trading venue
  - (ii) Swaps, forwards, and other currency derivatives
- (f) Structured finance instruments
- (g) Equity Derivatives
  - (i) Options and Futures admitted to trading on a trading venue
  - (ii) Swaps and other equity derivatives
- (h) Securitized Derivatives
  - (i) Warrants and Certificate Derivatives
  - (ii) Other securitized derivatives
- (i) Commodities derivatives and emission allowances Derivatives
  - (i) Options and Futures admitted to trading on a trading venue
  - (ii) Other commodities derivatives and emission allowances derivatives
- (j) Contracts for difference
- (k) Exchange traded products (Exchange traded funds, exchange traded notes and exchange traded commodities)
- (l) Emission allowances
- (m) Other instruments

**Annex II**

**Table 1**

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Class of Instrument					
Notification if <1 average trade per business day in the previous year	Y/N				
Top five execution venues ranked in terms of trading volumes (descending order)	Proportion of volume traded as a percentage of total in that class	Proportion of volume traded as a percentage of total in that class	Percentage of passive orders	Percentage of aggressive orders	Percentage of directed orders
Name and Venue Identifier (MIC or LEI)					
Name and Venue Identifier (MIC or LEI)					
Name and Venue Identifier (MIC or LEI)					
Name and Venue Identifier (MIC or LEI)					
Name and Venue Identifier (MIC or LEI)					

Table 2

Class of Instrument					
Notification if <1 average trade per business day in the previous year	Y/N				



Top five execution venues ranked in terms of trading volumes (descending order)	Proportion of volume traded as a percentage of total in that class	Proportion of orders executed as percentage of total in that class	Percentage of passive orders	Percentage of aggressive orders	Percentage of directed orders
Name and Venue Identifier (MIC or LEI)					
Name and Venue Identifier (MIC or LEI)					
Name and Venue Identifier (MIC or LEI)					
Name and Venue Identifier (MIC or LEI)					
Name and Venue Identifier (MIC or LEI)					

**Table 3**

Class of Instrument		
Notification if < 1 average trade per business day in the previous year	<b>Yes/No</b>	
Top 5 Venues ranked in terms of volume (descending	Proportion of volume executed as a percentage of total in that class	Proportion of orders executed as percentage of total in that class.

order)		
Name and Venue Identifier (MIC or LEI)		
Name and Venue Identifier (MIC or LEI)		
Name and Venue Identifier (MIC or LEI)		
Name and Venue Identifier (MIC or LEI)		
Name and Venue Identifier (MIC or LEI)		

Insert the new chapter COBS 11A after COBS 11 (Dealing and managing). In this chapter, all of the text is new and is not underlined.

## 11A Underwriting and placing

### General requirements concerning underwriting and placing

- 11A.1.1 G (1) This chapter contains a number of provisions marked with the status letters “EU”, which have been selectively reproduced from the *MiFID Org Regulation*;
- (2) This chapter reproduces provisions of the *MiFID Org Regulation* which are directly applicable to *MiFID Org Regulation* firms in relation to their *MiFID business*. Such *firms* should use the Official Journal of the European Union for a comprehensive statement of their obligations under the *MiFID Org Regulation*.
- (3) The purpose of *COBS 11.1.2R* is that these provisions are also applied in relation to other business and to other *firms* to which this chapter applies, as stated in that *rule*.
- 11A.1.2 R (1) Subject to (2) and (3), in this chapter provisions marked “EU” apply to a *firm’s* business other than *MiFID business* as if they were *rules*.
- (2) Any references within those provisions marked “EU” to other provisions of *EU* law must be interpreted in light of the purpose of

the *rule*.

- (3) In this chapter, provisions marked “EU” which derive from recitals to MiFID or the MiFID Org Regulation apply to all *firms* as *guidance*.

11A.1.3 EU Article 38(1) of the *MiFID Org Regulation* sets out requirements for *firms* to provide specified information to issuer *clients* before accepting a mandate to manage an offering.

- 38 (1) Investment firms which provide advice on corporate finance strategy, as set out in Section B(3) of Annex I, and provide the service of underwriting or placing of financial instruments, shall, before accepting a mandate to manage the offering, have arrangements in place to inform the issuer client of the following:
- (a) the various financing alternatives available with the firm, and an indication of the amount of transaction fees associated with each alternative;
  - (b) the timing and the process with regard to the corporate finance advice on pricing of the offer;
  - (c) the timing and the process with regard to the corporate finance advice on placing of the offering;
  - (d) details of the targeted investors, to whom the firm intends to offer the financial instruments;
  - (e) the job titles and departments of the relevant persons individuals involved in the provision of corporate finance advice on the price and allotment; and
  - (f) firm’s arrangements to prevent or manage conflicts of interest that may arise where the firm places the relevant financial instruments with its investment clients of with its own proprietary book.

11A.1.4 EU Article 38(2) and (3) of the *MiFID Org Regulation* sets out requirements to identify all underwriting and placing operations of a *firm* and to ensure that adequate controls are in place to manage any potential conflicts of interest.

- 38 (2) Investment firms shall have in place a centralised process to identify all underwriting and placing operations of the firm and record such information, including the date on which the firm was informed of potential underwriting and placing operations. Firms shall identify all potential conflicts of interest arising from other activities of the investment firm, or group, and implement appropriate management procedures. In cases where an investment firm cannot

manage a conflict of interest by way of implementing appropriate procedures, the investment firm shall not engage in the operation.

- (3) Investment firms providing execution and research services as well as carrying out underwriting and placing activities shall ensure adequate controls are in place to manage any potential conflicts of interest between these activities and between their different clients receiving those services.

11A.1.5 EU Article 39(1) of the *MiFID Org Regulation* sets out additional requirements in relation to pricing of offerings in relation to issuance of *financial instruments*.

- 39 (1) Investment firms shall have in place systems, controls and procedures to identify and prevent or manage conflicts of interest that arise in relation to possible under-pricing or over-pricing of an issue or involvement of relevant parties in the process. In particular, investment firms shall as a minimum requirement establish, implement and maintain internal arrangements to ensure both of the following:
- (a) ensure that the pricing of the offer does not promote the interests of other clients or firm's own interests, in a way that may conflict with the issuer client's interests; and
  - (b) the prevention or management of a situation where persons responsible for providing services to the firm's investment clients are directly involved in decisions about corporate finance advice on pricing to the issuer client.

11A.1.6 EU Article 39(2) of the *MiFID Org Regulation* sets out additional requirements concerning the provision of information.

- 39 (2) Investment firms shall provide clients with information about how the recommendation as to the price of the offering and the timings involved is determined. In particular, the firm shall inform and engage with the issuer client about any hedging or stabilisation strategies it intends to undertake with respect to the offering, including how these strategies may impact the issuer clients' interests. During the offering process, firms shall also take all reasonable steps to keep the issuer client informed about developments with respect to the pricing of the issue.

11A.1.7 EU Article 40 of the *MiFID Org Regulation* sets out additional requirements in

relation to placing.

- 40
- (1) Investment firms placing financial instruments shall establish, implement and maintain effective arrangements to prevent recommendations on placing from being inappropriately influenced by any existing or future relationships.
  - (2) Investment firms shall establish, implement and maintain effective internal arrangements to prevent or manage conflicts of interests that arise where persons responsible for providing services to the firm's investment clients are directly involved in decisions about recommendations to the issuer client on allocation.
  - (3) "Investment firms shall not accept any third-party payments or benefits unless such payments or benefits comply with the inducements requirements laid down in Article 24 or Directive 2014/65/EU. In particular, the following practices shall be considered not compliant with those requirements and shall therefore be considered not acceptable:
    - (a) an allocation made to incentivise the payment of disproportionately high fees or commissions paid by an investment client, or disproportionately high volumes of business at normal levels of commission provided by the investment client as a compensation for receiving an allocation of the issue;
    - (b) an allocation that is expressly or implicitly conditional on the receipt of future orders or the purchase of any other service from the investment firm by an investment client, or any entity of which the investor is a corporate officer.
    - (c) an allocation made to a senior executive or a corporate officer of an existing or potential issuer client, in consideration for the future or past award of corporate finance business ('spinning');
  - (4) Investment firms shall establish, implement and maintain an allocation policy that sets out the process for developing allocation recommendations. The allocation policy shall be provided to the issuer client before agreeing to undertake any placing services. The policy shall set out relevant information that is available at that stage, about the proposed allocation methodology for the issue.
  - (5) Investment firms shall involve the issuer client in discussions about the placing process in order for the firm to be able to understand and take into account the client's interests and

objectives. The investment firm shall obtain the issuer client's agreement to its proposed allocation per type of client for the transaction in accordance with the allocation policy.

11A.1.8 EU Article 41 of the MiFID Org Regulation sets out additional requirements in relation to advice, distribution and self-placement.

- 41
- (1) Investment firms shall have in place systems, controls and procedures to identify and manage the conflicts of interest that arise when providing investment service to an investment client to participate in a new issue, where the investment firm receives commissions, fees or any monetary or non-monetary benefits in relation to arranging the issuance. Any commissions, fees or monetary or non-monetary benefits shall comply with the requirements in Article 24(7), 24(8) and 24(9) of Directive 2014/65/EU and be documented in the investment firm's conflicts of interest policies and reflected in the firm's inducements arrangements.
  - (2) Investment firms engaging in the placement of financial instruments issued by themselves or by entities within the same group, to their own clients, including their existing depositor clients in the case of credit institutions, or investment funds managed by entities of their group, shall establish, implement and maintain clear and effective arrangements for the identification, prevention or management of the potential conflicts of interest that arise in relation to this type of activity. Such arrangements shall include consideration of refraining from engaging in the activity, where conflicts of interest cannot be appropriately managed so as to prevent any adverse effects on clients.
  - (3) When disclosure of conflicts of interest is required, investment firms shall comply with the requirements in Article 34(4), including an explanation of the nature and source of the conflicts of interest inherent to this type of activity, providing details about the specific risks related to such practices in order to enable clients to make an informed investment decision.
  - (4) Investment firms engaging in the offering of financial instruments issued by themselves or other group entities to their clients and those instruments are included in the calculation of prudential requirements specified in Regulation (EU) No 575/2013 of the European Parliament

and of the Council<sup>1</sup>, Directive 2013/36/EU of the European Parliament and of the Council<sup>2</sup> or Directive 2014/59/EU of the European Parliament and of the Council<sup>3</sup>, shall provide such clients with additional information explaining the differences between the financial instrument and bank deposits in terms of yield, risk, liquidity and any protection provided in accordance with Directive 2014/49/EU of the European Parliament and of the Council.

11A.1.9 EU Article 42 of the MiFID Org Regulation sets out additional requirements in relation to lending on provision of credit in the context of underwriting or placement

- 41 (1) Where any previous lending or credit to the issuer client by an investment firm, or an entity within the same group, may be repaid with the proceeds of an issue, the investment firm shall have arrangements in place to identify and prevent or manage any conflicts of interest that may arise as a result.
- (2) Where the arrangements taken to manage conflicts of interest prove insufficient to ensure that the risk of damage to the issuer client would be prevented, investment firms shall disclose to the issuer client the specific conflicts of interest that have arisen in relation to their, or group entities', activities in a capacity of credit provider, and their activities related to the securities offering.”
- (3) Investment firms' conflict of interest policy shall require the sharing of information about the issuer's financial situation with group entities acting as credit providers, provided this would not breach information barriers set up by the firm to protect the interests of a client.

11A.1.10 EU Article 43 of the MiFID Org Regulation sets out record keeping requirements in relation to underwriting or placing

“Investment firms shall keep records of the content and timing of instructions received from clients. A record of the allocation decisions taken for each operation shall be kept to provide for a complete audit trail between the movements registered in clients' accounts and the instructions received by the investment firm. In particular, the final allocation made to

<sup>1</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p.1)

<sup>2</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p.338)

<sup>3</sup> Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulation (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p.190)

each investment client shall be clearly justified and recorded. The complete audit trail of the material steps in the underwriting and placing process shall be made available to competent authorities upon request.”

Amend the following as shown.

## 12 Investment research

### 12.1 Purpose and application

...

Application: Where?

- 12.1.3 G The *EEA territorial scope rule* modifies the general *rule* of application to the extent necessary to be compatible with European law (see paragraph 1.1 of Part 2 of *COBS 1 Annex 1*). This means that *COBS 12.2* and ~~*COBS 12.3.4G*~~ also ~~apply~~ applies to *passport activities* carried on by a *UK MiFID investment firm* from a branch in another *EEA state*, but ~~de~~ does not apply to the *United Kingdom branch* of an *EEA MiFID investment firm* in relation to its *MiFID business*.

### 12.2 Investment research and non-independent research

Application

- 12.2.1 R This section ~~applies to a firm which produces, or arranges for the production of, investment research that is intended or likely to be subsequently disseminated to clients of the firm or to the public, under its own responsibility or that of a member of its group.~~ [deleted]

~~[Note: article 25(1) of the MiFID implementing Directive]~~

- 12.2.2 G The concept of dissemination of *investment research* ~~to clients or to the public is not intended to include dissemination exclusively to persons within the group of the firm.~~ [deleted]

~~[Note: recital 33 of the MiFID implementing Directive]~~

~~Measures and arrangements required for investment research~~

- 12.2.3 R ~~A firm must ensure the implementation of all of the measures for managing conflicts of interest in SYSC 10.1.11R in relation to the financial analysts involved in the production of investment research and other relevant persons whose responsibilities or business interests may conflict with the interests of the persons to whom investment research is disseminated.~~ [deleted]



~~[Note: article 25(1) of the MiFID implementing Directive]~~

- 12.2.4 G ~~Persons whose responsibilities or business interests may reasonably be considered to conflict with the interests of the persons to whom investment research is disseminated include corporate finance personnel and persons involved in sales and trading on behalf of clients or the firm. [deleted]~~

~~[Note: recital 30 of the MiFID implementing Directive]~~

- 12.2.5 R ~~A firm must have in place arrangements designed to ensure that the following conditions are satisfied: [deleted]~~

- (1) ~~if a financial analyst or other relevant person has knowledge of the likely timing or content of investment research which is not publicly available or available to clients and cannot readily be inferred from information that is so available, that financial analyst or other relevant person must not undertake personal transactions or trade on behalf of any other person, including the firm, other than as market maker acting in good faith and in the ordinary course of market making or in the execution of an unsolicited client order, in financial instruments to which the investment research relates, or in any related financial instruments, until the recipients of the investment research have had a reasonable opportunity to act on it;~~

~~[Note: article 25(2)(a) of the MiFID implementing Directive]~~

- (2) ~~in circumstances not covered by (1), financial analyst and any other relevant persons involved in the production of investment research must not undertake personal transactions in financial instruments to which the investment research relates, or in any related financial instrument, contrary to current recommendations, except in exceptional circumstances and with the prior approval of a member of the firm's legal or compliance function;~~

~~[Note: article 25(2)(b) of the MiFID implementing Directive]~~

- (3) ~~the firm itself, financial analysts, and other relevant persons involved in the production of investment research must not accept inducements from those with a material interest in the subject matter of the investment research;~~

~~[Note: article 25(2)(c) of the MiFID implementing Directive]~~

- (4) ~~the firm itself, financial analysts, and other relevant persons involved in the production of investment research must not promise issuers favourable research coverage; and~~

~~[Note: article 25(2)(d) of the MiFID implementing Directive]~~

- (5) ~~issuers, relevant persons other than financial analysts, and any other persons must not, before the dissemination of investment research,~~

be permitted to review a draft of the *investment research* for the purpose of verifying the accuracy of factual statements made in that *investment research*, or for any other purpose other than verifying compliance with the *firm's* legal obligations, if the draft includes a recommendation or a target price.

[~~Note: article 25(2)(e) of the *MiFID implementing Directive*~~]

- 12.2.5A G ~~Firms are reminded that they must also comply with COBS 11.7 (Rule on personal account dealing): [deleted]~~
- 12.2.6 G ~~Knowledge by a *financial analyst* or other *relevant person* that the *firm* intends to produce or disseminate *investment research* to its *clients* or to the public (including in circumstances where research material has not yet been written) could constitute knowledge of the likely timing and content of *investment research* under COBS 12.2.5R(1): [deleted]~~
- 12.2.7 G ~~For the purposes of COBS 12.2.5R(2):~~
- (1) ~~current recommendations should be considered to be those recommendations contained in *investment research* which have not been withdrawn and which have not lapsed; and~~
- ~~[Note: recital 34 of the *MiFID implementing Directive*]~~
- (2) ~~exceptional circumstances in which *financial analysts* and other *relevant persons* may, with prior written approval, undertake *personal transactions in financial instruments* to which *investment research* relates should include those circumstances where, for personal reasons relating to financial hardship, the *financial analyst* or other *relevant person* is required to liquidate a position: [deleted]~~
- ~~[Note: recital 31 of the *MiFID implementing Directive*]~~
- 12.2.8 G ~~Small gifts or minor hospitality below a level specified in the *firm's conflicts of interest policy* and mentioned in the description of that policy that is made available to *clients* in accordance with COBS 6.1.4R(8) should not be considered as inducements for the purposes of COBS 12.2.5R(3): [deleted]~~
- ~~[Note: recital 32 of the *MiFID implementing Directive*]~~
- 12.2.9 G ~~A *financial analyst* should not become involved in activities other than the preparation of *investment research* where such involvement is inconsistent with the maintenance of the *financial analysts* objectivity. The following should ordinarily be considered as inconsistent with the maintenance of a *financial analyst's* objectivity:~~
- (1) ~~participating in investment banking activities such as corporate finance business and underwriting; or~~
- (2) ~~participating in 'pitches' for new business or 'road shows' for new~~

issues of *financial instruments*; or

- (3) being otherwise involved in the preparation of issuer marketing. [deleted]

~~[Note: recital 36 of the *MiFID implementing Directive*]~~

#### ~~Exemption from investment research measures and arrangements~~

12.2.10 R A *firm* which disseminates *investment research* produced by another *person* to the public or to *clients* is exempt from complying with the requirements in *COBS 12.2.3R* and *COBS 12.2.5R* if the following criteria are met:

- (1) the *person* that produces the *investment research* is not a member of the *group* to which the *firm* belongs;
- (2) the *firm* does not substantially alter the recommendations within the *investment research*;
- (3) the *firm* does not present the *investment research* as having been produced by it; and
- (4) the *firm* verifies that the producer of the *investment research* is subject to requirements equivalent to those in *COBS 12.2.3 R* and *COBS 12.2.5 R* in relation to the production of that *investment research*, or has established a policy setting such requirements. [deleted]

~~[Note: article 25(3) of the *MiFID implementing Directive*]~~

#### ~~Means and timing of publication of investment research~~

12.2.11 G The *FCA* would expect a *firm's conflicts of interest policy* to provide for *investment research* to be published or distributed to its *clients* in an appropriate manner. For example, the *FCA* considers it will be:

- (1) appropriate for a *firm* to take reasonable steps to ensure that its *investment research* is published or distributed only through its usual *distribution channels*; and
- (2) inappropriate for an *employee* (whether or not a *financial analyst*) to communicate the substance of any *investment research*, except as set out in the *firm's conflicts of interest policy*. [deleted]

12.2.12 G The *FCA* would expect a *firm* to consider whether or not other business activities of the *firm* could create the reasonable perception that its *investment research* may not be an impartial analysis of the market in, or the value or prospects of, a *financial instrument*. A *firm* would therefore be expected to consider whether its conflicts of interest policy should contain any restrictions on the timing of the publication of *investment research*. For example, a *firm* might consider whether it should restrict publication of relevant *investment research* around the time of an investment offering.

[deleted]

Investment research for internal use

- 12.2.13 G ~~The FCA considers that the significant conflicts of interest which could arise are likely to mean it is inappropriate for a *financial analyst* or other *relevant person* to prepare *investment research* which is intended firstly for internal use for the *firm's* own advantage, and then for later publication to its *clients* (in circumstances in which it might reasonably be expected to have a material influence on its *clients'* investment decisions). [deleted]~~

Application

- 12.2.14 G This section applies to a *firm* that:
- (1) produces, or arranges for the production of, *investment research* that is intended or likely to be subsequently disseminated to *clients* of the *firm* or to the public, under its own responsibility or that of a member of its *group*; or
  - (2) produces or disseminates *non-independent research*.
- 12.2.15 R Where this section applies to a *firm* in relation to business other than its *MiFID business*, provisions in this section marked “EU” shall apply as if they were *rules*, other than those that copy out recitals, which shall apply as if they were *guidance*.
- 12.2.16 G (1) This section applies to both *investment research* and *non-independent research*.
- (2) *Non-independent research* is not presented as objective or independent and is accordingly considered a marketing communication.
- (3) Both *investment research* and *non-independent research* are sub-categories of the type of information defined as an *investment recommendation* in COBS 12.4.

Investment research and non-independent research

- 12.2.17 EU Article 36(1) of the *MiFID Org Regulation* defines *investment research*.

36 (1) For the purposes of Article 37 investment research shall be research or other information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers of financial instruments, including any opinion as to the present or future value or price of such instruments, intended for distribution channels or for the public, and in relation to which the following conditions are met:

- (a) the research or information is labelled or described as investment research or in similar terms, or is otherwise presented as an objective or independent explanation of the matters contained in the recommendation;
- (b) if the recommendation in question were made by an investment firm to a client, it would not constitute the provision of investment advice for the purposes of Directive 2014/65/EU.

12.2.18 EU Article 36(2) of the *MiFID Org Regulation* deals with the treatment of *non-independent research* with reference to *investment recommendations* as defined in the *Market Abuse Regulation* (see *COBS 12.4*) and in contrast to *investment research* as defined in article 36(1) (see *COBS 12.2.17EU*).

36 (2) A recommendation of the type covered by point (35) of Article 3(1) of Regulation (EU) 596/2014 that does not meet the conditions set out in paragraph 1 shall be treated as a marketing communication for the purposes of Directive 2014/65/EU and investment firms that produce or disseminate that recommendation shall ensure that it is clearly identified as such.

Additionally, firms shall ensure that any such recommendation contains a clear and prominent statement that (or, in the case of an oral recommendation, to the effect that) it has not been prepared in accordance with legal requirements designed to promote the independence of investment research, and that it is not subject to any prohibition on dealing ahead of the dissemination of investment research.

#### Conflicts of interest

12.2.19 EU Article 37(1) of the *MiFID Org Regulation* requires *firms* to apply the conflicts requirements set out in article 34(3) of the *MiFID Org Regulation* to *persons* involved in the production of *investment research* and *non-independent research*. Recitals 51, 52 and 55 to the *MiFID Org Regulation* relate to the required measures and arrangements.

37 (1) Investment firms which produce, or arrange for the production of, investment research that is intended or likely to be subsequently disseminated to clients of the firm or to the public, under their own responsibility or that of a member of their group, shall ensure the implementation of all the measures set out in Article 34(3) in relation to the financial analysts involved in the production of the investment research and other relevant persons whose responsibilities or business interests may conflict with the interests of the persons to whom the investment research is disseminated.

The obligations in the first subparagraph shall also apply in relation to recommendations referred to in Article 36(2).

Recital 51

The measures and arrangements adopted by an investment 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 financial analysts and of the investment research they produce. Those measures and arrangements should ensure that financial analysts enjoy an adequate degree of independence from the interests of persons whose responsibilities or business interests may reasonably be considered to conflict with the interests of the persons to whom the investment research is disseminated.

Recital 52

Persons whose responsibilities or business interests may reasonably be considered to conflict with the interests of the persons to whom investment research is disseminated should include corporate finance personnel and persons involved in sales and trading on behalf of clients or the firm.

Recital 55

The concept of dissemination of investment research to clients or the public should not include dissemination exclusively to persons within the group of the investment firm. Current recommendations should be considered to be those recommendations contained in investment research which have not been withdrawn and which have not lapsed. The substantial alteration of investment research produced by a third party should be governed by the same requirements as the production of research.

- 12.2.20 G (1) Firms which produce, or arrange for the production of, investment research or non-independent research are also reminded of their obligations under SYSC 10 (Conflicts of interest).
- (2) COBS 12.2.19EU relates to the management of conflicts of interest in relation to investment research.
- (3) In relation to non-independent research, firms may wish to consider whether conflicts arise in relation to:
- (a) relevant persons trading in financial instruments that are the subject of non-independent research which they know the firm has published or intends to publish before clients have had a reasonable opportunity to act on it (other than when the firm is acting as market maker in good faith and in the ordinary course of market making, or in the execution of an unsolicited client order); and
- (b) the preparation of non-independent research which is

intended first for internal use by the *firm* and then for later publication to *clients*.

Measures and arrangements required for investment research

12.2.21 EU Article 37(2) of the *MiFID Org Regulation* requires *firms* to put arrangements in place around the production of *investment research* to ensure the conditions set out in that article are satisfied. Recitals 53, 54 and 56 relate to those arrangements and the article 37(2) conditions.

- 37 (2) Investment firms referred to in the first subparagraph of paragraph 1 shall have in place arrangements designed to ensure that the following conditions are satisfied:
- (a) financial analysts and other relevant persons do not undertake personal transactions or trade, other than as market makers acting in good faith and in the ordinary course of market making or in the execution of an unsolicited client order, on behalf of any other person, including the investment firm, in financial instruments to which investment research relates, or in any related financial instruments, with knowledge of the likely timing or content of that investment research which is not publicly available or available to clients and cannot readily be inferred from information that is so available, until the recipients of the investment research have had a reasonable opportunity to act on it;
  - (b) in circumstances not covered by point (a), financial analysts and any other relevant persons involved in the production of investment research do not undertake personal transactions in financial instruments to which the investment research relates, or in any related financial instruments, contrary to current recommendations, except in exceptional circumstances and with the prior approval of a member of the firm's legal or compliance function;
  - (c) a physical separation exists between the financial analysts involved in the production of investment research and other relevant persons whose responsibilities or business interests may conflict with the interests of the persons to whom the investment research is disseminated or, when considered not appropriate to the size and organisation of the firm as well as the nature, scale and complexity of its business, the establishment and implementation of appropriate alternative information barriers;
  - (d) the investment firms themselves, financial analysts,

and other relevant persons involved in the production of the investment research do not accept inducements from those with a material interest in the subject-matter of the investment research;

- (e) the investment firms themselves, financial analysts, and other relevant persons involved in the production of the investment research do not promise issuers favourable research coverage;
- (f) before the dissemination of investment research issuers, relevant persons other than financial analysts, and any other persons are not permitted to review a draft of the investment research for the purpose of verifying the accuracy of factual statements made in that research, or for any purpose other than verifying compliance with the firm's legal obligations, where the draft includes a recommendation or a target price.

For the purposes of this paragraph, 'related financial instrument' shall be any financial instrument the price of which is closely affected by price movements in another financial instrument which is the subject of investment research, and includes a derivative on that other financial instrument.

#### Recital 53

Exceptional circumstances in which financial analysts and other persons connected with the investment firm who are involved in the production of investment research may, with prior written approval, undertake personal transactions in instruments to which the research relates should include those circumstances where, for personal reasons relating to financial hardship, the financial analyst or other person is required to liquidate a position.

#### Recital 54

Fees, commissions, monetary or non-monetary benefits received by the firm providing investment research from any third party should only be acceptable when they are provided in accordance with requirements specified in Article 24(9) of Directive 2014/65/EU and Article 13 of Commission Delegated Directive (EU) .../... [to be inserted before adoption] of XXX supplementing Directive 2014/65/EU 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.

#### Recital 56

Financial analysts should not engage in activities other than the preparation



of investment research where engaging in such activities are inconsistent with the maintenance of that person's objectivity. These include participating in investment banking activities such as corporate finance business and underwriting, participating in 'pitches' for new business or 'road shows' for new issues of financial instruments; or being otherwise involved in the preparation of issuer marketing.

12.2.22 EU Article 37(3) of the MiFID Org Regulation provides for exemptions from article 37(1) of the MiFID Org Regulation (COBS 12.2.19EU).

37 (3) Investment firms which disseminate investment research produced by another person to the public or to clients shall be exempt from complying with paragraph 1 if the following criteria are met:

- (a) the person that produces the investment research is not a member of the group to which the investment firm belongs;
- (b) the investment firm does not substantially alter the recommendations within the investment research;
- (c) the investment firm does not present the investment research as having been produced by it;
- (d) the investment firm verifies that the producer of the research is subject to requirements equivalent to the requirements under this Regulation in relation to the production of that research, or has established a policy setting such requirements.

12.2.23 G The FCA would expect a firm's conflicts of interest policy to provide for investment research to be published or distributed to its clients in an appropriate manner. For example, the FCA considers it will be:

- (1) appropriate for a firm to take reasonable steps to ensure that its investment research is published or distributed only through its usual distribution channels;
- (2) inappropriate for an employee (whether or not a financial analyst) to communicate the substance of any investment research, except as set out in the firm's conflicts of interest policy; and
- (3) inappropriate for a financial analyst or other relevant person to prepare investment research which is intended first for internal use for the firm's own advantage, and then for later publication to its clients (in circumstances in which it might reasonably be expected to have a material influence on its clients' investment decisions).

12.2.24 G The FCA would expect a firm to consider whether or not other business activities of the firm could create the reasonable perception that its investment research may not be an impartial analysis of the market in, or the

value or prospects of, a financial instrument. A firm would therefore be expected to consider whether its conflicts of interest policy should contain any restrictions on the timing of the publication of investment research. For example, a firm might consider whether it should restrict publication of relevant investment research around the time of an investment offering.

COBS 12.3 (Non-independent research) is deleted in its entirety as shown below.

### 12.3 Non-independent research ~~[deleted]~~

#### Application

- ~~12.3.1 R This section applies to a firm that produces or disseminates non-independent research.~~

~~[Note: article 24(2) of the MiFID implementing Directive]~~

#### Labelling of non-independent research

- ~~12.3.2 R A firm which produces or disseminates non-independent research must ensure that it:~~

- ~~(1) is clearly identified as a marketing communication; and~~
- ~~(2) contains a clear and prominent statement that (or, in the case of an oral recommendation, to the effect that) it:~~
- ~~(a) has not been prepared in accordance with legal requirements designed to promote the independence of investment research; and~~
- ~~(b) is not subject to any prohibition on dealing ahead of the dissemination of investment research.~~

~~[Note: article 24(2) of the MiFID implementing Directive]~~

- ~~12.3.3 R The financial promotion rules apply to non-independent research as though it were a marketing communication.~~

~~[Note: article 24(2) of the MiFID implementing Directive]~~

#### Management of conflicts of interest in area of non-independent research

- ~~12.3.4 G In accordance with SYSC 10, a firm will be expected to take reasonable steps to identify and manage conflicts of interest which may arise in the production of non-independent research. Situations where conflicts of interest can arise include:~~

- ~~(1) relevant persons trading in financial instruments that are the subject of non-independent research which they know the firm has~~

~~published or intends to publish before *clients* have had a reasonable opportunity to act on it (other than when the *firm* is acting as *market maker* in good faith and in the ordinary course of market making, or in the execution of an unsolicited *client* order); and~~

- ~~(2) preparation of *non-independent research* which is intended firstly for internal use by the firm and then for later publication to *clients*.~~

Amend the following as shown.

## 14 Providing product information to clients

...

### 14.3 Information about designated investments (non-MiFID provisions)

Application

14.3.1 R This section applies to a *firm* in relation to:

- (1) ~~*MiFID or equivalent third country business*~~; and [deleted]
- (2) the following *regulated activities* when carried on for a *retail client*:
  - (a) making a *personal recommendation* about a *designated investment*; or
  - (b) *managing investments* that are *designated investments* (other than a *P2P agreement*); or
  - (c) *arranging, (bringing about) or executing a deal* in a *warrant, non-readily realisable security or derivative*; or
  - (d) engaging in *stock lending activity*; or
  - (e) *operating an electronic system in relation to lending*, but only in relation to facilitating a person becoming a lender under a *P2P agreement*,

except to the extent that the carrying on of such a *regulated activity* constitutes *MiFID, equivalent third country or optional exemption business*.

14.3.1A G A *firm* carrying on *MiFID, equivalent third country or optional exemption business* should consider whether the requirements in Articles 46 and 48 of the *MiFID Org Regulation* apply, see COBS 14.3A (information about financial instruments (MiFID provisions)).

Providing a description of the nature and risks of designated investments

14.3.2 R ...

~~[Note: article 31(1) and (2) of the *MiFID implementing Directive*]~~

14.3.3 R ...

~~[Note: article 31(3) of the *MiFID implementing Directive*]~~

14.3.4 R ...

~~[Note: article 31(4) of the *MiFID implementing Directive*]~~

14.3.5 R ...

~~[Note: article 31(5) of the *MiFID implementing Directive*]~~

Satisfying the provision rules

14.3.6 G (1) ~~A *firm* need not treat each of several transactions in respect of the same type of *financial instrument* as a new or different service and so does not need to comply with the provision rules (COBS 14.3.2R to COBS 14.3.5R) in relation to each transaction.~~

(2) ~~But a *firm* should ensure that the *client* has received all relevant information in relation to a transaction, such as details of product charges that differ from those already disclosed. [deleted]~~

~~[Note: in respect of (1), recital 50 to the *MiFID implementing Directive*]~~

...

Product information: form

14.3.8 R ...

~~[Note: article 29(4) of the *MiFID implementing Directive*]~~

The timing rules

14.3.9 R (1) The information to be provided in accordance with the *rules* in this section must be provided in good time before a *firm* carries on *designated investment business* ~~or ancillary services~~ with or for a *retail client*.

(2) ...

~~[Note: article 29(2) and (5) of the *MiFID implementing Directive*]~~

Keeping the client up-to-date

14.3.10 R ...

~~[Note: article 29(6) of the *MiFID implementing Directive*]~~

## Information about UCITS schemes

14.3.11 R ...

~~[Note: article 34 of the MiFID implementing Directive]~~

14.3.12 G A *key investor information document* and *EEA key investor information document* provide sufficient information in relation to the costs and associated charges in respect of the *UCITS* itself. However, a *firm* distributing *units* in a *UCITS* should also inform a *client* about all of the other costs and associated charges related to the provision of its services in relation to *units* in the *UCITS*.

~~[Note: recital 55 to the MiFID implementing Directive]~~

After COBS 14.3 (Information about designated investments (non-MiFID provisions)) insert the following new section. All the text is new and is not underlined.

### 14.3A Information about financial instruments (MiFID provisions)

#### Application

14.3A.1 R This section applies to a *firm* in relation to its *MiFID*, *equivalent third country* or *optional exemption business*.

Effect of provisions marked “EU” for third country investment firms and MiFID optional exemption firms

- 14.3A.2 R
- (1) Provisions in this chapter marked “EU” apply in relation to *MiFID optional exemption business* as if they were *rules* (COBS 1.2.2G).
  - (2) The effect of *GEN 2.2.22AR* is that provisions in this chapter marked “EU” also apply in relation to the *equivalent business of a third country investment firm* as if they were *rules*.

Providing a description of the nature and risks of financial instruments

- 14.3A.3 R A *firm* must provide a *client* with:
- (a) appropriate guidance on, and warnings of, the risks associated with investments in *financial instruments* or in respect of particular investment strategies; and
  - (b) information on whether a particular *financial instrument* is intended for *retail* or *professional clients*, taking account of the identified target market for the purposes of the *rule* in *PROD* [X].

[Note: article 24(4)(b) of *MiFID*]

14.3A.4 G *COBS* 14.3A.3R supplements *COBS* 2.2A.2R (Information disclosure before providing services (MiFID provisions)).

14.3A.5 EU 48(1) Investment firms shall provide clients or potential clients in good time before the provision of investment services or ancillary services to clients or potential clients with a general description of the nature and risks of financial instruments, taking into account, in particular, the client's categorisation as either a retail client, professional client or eligible counterparty. That description shall explain the nature of the specific type of instrument concerned, the functioning and performance of the financial instrument in different market conditions, including both positive and negative conditions, as well as the risks particular to that specific type of instrument in sufficient detail to enable the client to take investment decisions on an informed basis.

48(2) The description of risks referred to in paragraph 1 shall include, where relevant to the specific type of instrument concerned and the status and level of knowledge of the client, the following elements:

- (a) the risks associated with that type of financial instrument including an explanation of leverage and its effects and the risk of losing the entire investment including the risks associated with insolvency of the issuer or related events, such as bail in;
- (b) the volatility of the price of such instruments and any limitations on the available market for such instruments;
- (c) information on impediments or restrictions for disinvestment, for example as may be the case for illiquid financial instruments or financial instruments with a fixed investment term, including an illustration of the possible exit methods and consequences of any exit, possible constraints and the estimated time frame for the sale of the financial instrument before recovering the initial costs of the transaction in that type of financial instruments;
- (d) the fact that an investor might assume, as a result of transactions in such instruments, financial commitments and other additional obligations, including contingent liabilities, additional to the cost of acquiring the instruments;
- (e) any margin requirements or similar obligations, applicable to instruments of that type.

48(3) Where an investment firm provides a retail client or potential retail client with information about a financial instrument that is the subject of a current offer to the public and a prospectus has been published in connection with that offer in accordance with

Directive 2003/71/EC, that firm shall in good time before the provision of investment services or ancillary services to clients or potential clients inform the client or potential client where that prospectus is made available to the public.

- 48(4) Where a financial instrument is composed of two or more different financial instruments or services, the investment firm shall provide an adequate description of the legal nature of the financial instrument, the components of that instrument and the way in which the interaction between the components affects the risks of the investment.
- 48(5) In the case of financial instruments that incorporate a guarantee or capital protection, the investment firm shall provide a client or a potential client with information about the scope and nature of such guarantee or capital protection. When the guarantee is provided by a third party, information about the guarantee shall include sufficient detail about the guarantor and the guarantee to enable the client or potential client to make a fair assessment of the guarantee.

[**Note:** article 48 of the *MiFID Org Regulation*]

Satisfying the provision rules

- 14.3A.6 G (1) Where a *firm* is required to provide information to a *client* before the provision of a service, each transaction in respect of the same type of *financial instrument* should not be considered as the provision of a new or different service.

[**Note:** article 69 to the *MiFID Org Regulation*]

- (2) But a *firm* should ensure that the *client* has received all relevant information in relation to a transaction which subsequently takes place, such as details of product charges that differ from those disclosed in respect of the prior transaction or transactions.

Timing of disclosure

- 14.3A.7 EU 46(2) Investment firms shall, in good time before the provision of investment services or ancillary services to clients or potential clients, to provide the information required under Articles 47 to 50.

[**Note:** article 46(2) of the *MiFID Org Regulation*]

- 14.3A.8 G The provisions in *COBS* that reproduce the information requirements contained in Articles 47 to 50 of the *MiFID Org Regulation* are: *COBS* 6.1-A.2.1 EU, *COBS* 6.1-A.2.4EU, *COBS* 6.1-A.2.5 EU, *COBS* 6.1-A.2.10EU and *COBS* 14.3A.5EU.

Medium of disclosure

- 14.3A.9 EU 46(3) The information referred to in paragraphs 1 and 2 shall be provided in a durable medium or by means of a website (where it does not constitute a durable medium) provided that the conditions specified in Article 3(2) are satisfied.

[Note: article 46(3) of the *MiFID Org Regulation*]

Keeping the client up-to-date

- 14.3A.10 EU 46(4) Investment firms shall notify a client in good time about any material change to the information provided under Articles 47 to 50 which is relevant to a service that the firm is providing to that client. That notification shall be given in a durable medium if the information to which it relates is given in a durable medium.

[Note: article 46(4) of the *MiFID Org Regulation*]

Information provided in accordance with the UCITS Directive and the PRIIPs Regulation

- 14.3A.11 EU 51 Investment firms distributing units in collective investment undertakings or PRIIPs shall additionally inform their clients about any other costs and associated charges related to the product which may have not been included in the UCITS KID or PRIIPs KID and about the costs and charges relating to their provision of investment services in relation to that financial instrument.

[Note: article 51 of the *MiFID Org Regulation*]

Amend the following as shown.

## 16 Reporting information to clients (non-MiFID provisions)

### 16.1 ~~General client reporting requirement~~ Application

- 16.1.1 R ~~A firm must ensure in relation to *MiFID* or equivalent third country business that a client receives adequate reports on the services provided to it by the firm. The reports must include, where applicable, the costs associated with the transactions and services undertaken by the firm on behalf of the client.~~  
[deleted]

~~[Note: article 19(8) of *MiFID*]~~

- 16.1.2 R This chapter applies in relation to *designated investment business* other than *MiFID, equivalent third country or optional exemption business.*



## 16.2 Occasional reporting

Execution of orders other than when managing investments

16.2.1 R ...

~~[Note: article 40 paragraphs (1) to (4) of the MiFID implementing Directive and article 24 of the UCITS implementing Directive]~~

...

16.2.3 R ...

~~[Note: article 40(4) of the MiFID implementing Directive]~~

...

Special cases

16.2.6 R ~~In relation to business that is not MiFID or equivalent third country business, a A firm need not despatch a confirmation if:~~

...

Record keeping: occasional reporting

16.2.7 R A firm must retain a copy of any confirmation despatched to a client under this section:

~~(a) for MiFID or equivalent third country business, for a period of at least five years; or~~

~~(b) for business that is not MiFID or equivalent third country business, for a period of at least three years;~~

from the date of despatch.

~~[Note: see article 51(3) of the MiFID implementing Directive]~~

## 16.3 Periodic reporting

Provision by the firm and contents

16.3.1 R (1) If a firm is managing investments on behalf of a client, it must provide the client with a periodic statement in a durable medium unless:

(a) such a statement is provided by another person; or

(b) all of the conditions in (1A) is satisfied.

- (1A) The conditions are that:
- (a) the firm provides the client with access to an online system which qualifies as a durable medium;
  - (b) the online system provides the client with easy access to:
    - (i) up-to-date valuations of the client's designated investments and client money; and
    - (ii) the information that would otherwise be contained in a periodic statement; and
  - (c) the firm has evidence that the client has accessed a valuation of their designated investments or client money at least once during the previous quarter.

(2) ...

~~[Note: article 41(1) and (2) of the MiFID implementing Directive]~~

16.3.2 R ...

~~[Note: article 41(3) of the MiFID implementing Directive]~~

16.3.3 R ...

(2) If the client is a retail client, the firm must send ~~him~~ the client a notice confirming the transaction and containing such of the information identified in column (1) of the table in COBS 16 Annex IR as is applicable:

...

~~[Note: article 41(4) of the MiFID implementing Directive]~~

...

16.3.5 R ...

~~[Note: article 40(4) of the MiFID implementing Directive]~~

16.3.6 R ...

~~[Note: article 42 of the MiFID implementing Directive]~~

Contingent liability transactions

16.3.7 R ...

~~[Note: recital 63 of the MiFID implementing Directive]~~

...

## Guidance on contingent liability transactions

- 16.3.9 G When providing a *periodic statement* to a *retail client*, a *firm* should consider whether to include:

...

## Periodic reporting: special situations

- 16.3.10 R ~~In relation to business that is not *MiFID* or equivalent third country business, a *firm* need not provide a *periodic statement*:~~

...

## Record keeping: periodic reporting

- 16.3.11 R A *firm* must make, and retain, a copy of any *periodic statement*:
- (1) ~~for *MiFID* or equivalent third country business, for a period of at least five years; or~~
- (2) ~~for business that is not *MiFID* or, for a period of at least three years;~~
- from the date of despatch.

~~[Note: see article 51(3) of the *MiFID implementing Directive*]~~

## 16.4 Statements of client designated investments or client money

- 16.4.1 R (1) A *firm* that holds *client designated investments* or *client money* for a *client* must send that *client* at least once a year a statement in a *durable medium* of those *designated investments* or that *client money* unless:
- (a) such a statement has been provided in a *periodic statement*;  
or
- (b) the *firm*:
- (i) provides the *client* with access to an online system, which qualifies as a *durable medium*, where up-to-date statements of a *client's designated investments* or *client money* can be easily accessed by the *client*; and
- (ii) the *firm* has evidence that the *client* has accessed an up-to-date statement at least once during the previous quarter.

...

- (3) This rule does not apply in relation to a firm holding *client designated investments* or *client money* under a *personal pension scheme* or a *stakeholder pension scheme*. ~~where doing so is not *MiFID* or *equivalent third country business*~~
- (4) A *CTF* account provider holding *client designated investments* or *client money* under a *CTF*, where doing so is not ~~*MiFID* or *equivalent third country business*~~ *MiFID, equivalent third country or optional exemption business*, must provide a statement but need not do so more frequently than required by Regulation 10 of the *CTF Regulations*.

~~[Note: article 43(1) of the *MiFID implementing Directive*]~~

16.4.2 R A firm must include the following information in a statement of *client* assets referred to under this section ~~the following information~~:

- (1) details of all the *designated investments* or *client money* held by the firm for the *client* at the end of the period covered by the statement;
- (2) the extent to which any *client designated investments* or *client money* have been the subject of *securities financing transactions*; and
- (3) the extent of any benefit that has accrued to the *client* by virtue of participation in any *securities financing transactions*, and the basis on which that benefit has accrued.

~~[Note: see article 43(2) of the *MiFID implementing Directive*]~~

16.4.3 R ...

~~[Note: see article 43(2) of the *MiFID implementing Directive*]~~

16.4.4 R ...

~~[Note: see article 43(3) of the *MiFID implementing Directive*]~~

...

**16 Annex 1R Trade confirmation and periodic information**

This annex forms part of *COBS* 16.2.1R

...		
<del>[Note: article 40(4) and recital 64 to the <i>MiFID implementing Directive</i>]</del>		
...		
<del>[Note: article 40(5) of the <i>MiFID implementing Directive</i>]</del>		

**16 Annex 2R Information to be included in a ~~Periodic~~ periodic report**

This annex forms part of COBS 16.3.1R.

...		
<del>[Note: article 41(2) of MiFID implementing Directive]</del>		

After COBS 16 (Reporting information to clients (non-MiFID provisions)) insert the following new section. All the text is new and is not underlined.

**16A Reporting information to clients (MiFID provisions)****16A.1 Application**

- 16A.1.1 R This section applies to a *firm* in relation to its *MiFID, equivalent third country or optional exemption business*.

Effect of provisions marked “EU” for third country investment firms and MiFID optional exemption firms

- 16A.1.2 R (1) Provisions in this chapter marked “EU” apply in relation to *MiFID optional exemption business* as if they were *rules*.
- (2) The effect of *GEN 2.2.22AR* is that provisions in this chapter marked “EU” also apply in relation to the *equivalent business of a third country investment firm* as if they were *rules*.

**16A.2 General client reporting and record keeping requirements**

- 16A.2.1 R (1) A *firm* must provide a *client* with adequate reports on the service provided in a *durable medium*.
- (2) The reports must include:
- (a) periodic communications to the *client*, taking into account the type and the complexity of the *financial instruments* involved and the nature of the service provided to the *client*; and
- (b) where applicable, the costs associated with the transactions and services undertaken on behalf of the *client*.

[~~Note: article 25(6) of MIFID~~]

- 16A.2.2 G A *firm* should refer to SYSC 9 (Record-keeping) for the requirements that

apply in relation to the retention of records

### 16A.3 Occasional reporting

Execution of orders other than when undertaking portfolio management

16A.3.1	EU	<p>59(1) Investment firms having carried out an order on behalf of a client, other than for portfolio management, shall, in respect of that order:</p> <ul style="list-style-type: none"> <li>(a) promptly provide the client, in a durable medium, with the essential information concerning the execution of that order;</li> <li>(b) send a notice to the client in a durable medium confirming execution of the order as soon as possible and no later than the first business day following execution or, where the confirmation is received by the investment firm from a third party, no later than the first business day following receipt of the confirmation from the third party.</li> </ul> <p>Point (b) shall not apply where the confirmation would contain the same information as a confirmation that is to be promptly dispatched to the client by another person.</p> <p>Points (a) and (b) shall not apply where orders executed on behalf of clients relate to bonds funding mortgage loan agreements with the said clients, in which case the report on the transaction shall be made at the same time as the terms of the mortgage loan are communicated, but no later than one month after the execution of the order.</p> <p>59(2) In addition to the requirements under paragraph 1, investment firms shall supply the client, on request, with information about the status of his order.</p> <p>59(3) In the case of client orders relating to units or shares in a collective investment undertaking which are executed periodically, investment firms shall either take the action specified in point (b) of paragraph 1 or provide the client, at least once every six months, with the information listed in paragraph 4 in respect of those transactions.</p> <p>59(4) The notice referred to in point (b) of paragraph 1 shall include such of the following information as is applicable and, where relevant, in accordance with the regulatory technical standards on reporting obligations adopted in accordance with Article 26 of Regulation (EU) No 600/2014:</p> <ul style="list-style-type: none"> <li>(a) the reporting firm identification;</li> </ul>
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- (b) the name or other designation of the client;
- (c) the trading day;
- (d) the trading time;
- (e) the type of the order;
- (f) the venue identification;
- (g) the instrument identification;
- (h) the buy/sell indicator;
- (i) the nature of the order if other than buy/sell;
- (j) the quantity;
- (k) the unit price;
- (l) the total consideration;
- (m) a total sum of the commissions and expenses charged and, where the client so requests, an itemised breakdown including, where relevant, the amount of any mark-up or mark-down imposed where the transaction was executed by an investment firm when dealing on own account, and the investment firm owes a duty of best execution to the client;
- (n) the rate of exchange obtained where the transaction involves a conversion of currency;
- (o) the client's responsibilities in relation to the settlement of the transaction, including the time limit for payment or delivery as well as the appropriate account details where these details and responsibilities have not previously been notified to the client;
- (p) where the client's counterparty was the investment firm itself or any person in the investment firm's group or another client of the investment firm, the fact that this was the case unless the order was executed through a trading system that facilitates anonymous trading.

For the purposes of point (k), where the order is executed in tranches, the investment firm may supply the client with information about the price of each tranche or the average price. Where the average price is provided, the investment firm shall supply the client with information about the price of each tranche upon request.

59(5) The investment firm may provide the client with the information referred to in paragraph 4 using standard codes if it also provides an explanation of the codes used.

[**Note:** article 59 of the *MiFID Org Regulation*]

- 16A.3.2 G In determining what is essential information, a *firm* should consider including:
- (1) for transactions in a *derivative*:
    - (a) the maturity, delivery or expiry date of the *derivative*;
    - (b) in the case of an *option*, a reference to the last exercise date, whether it can be exercised before maturity and the strike price; and
    - (c) if the transaction *closes out* an open *futures* position, all essential details required in respect of each contract comprised in the open position and each contract by which it was *closed out* and the profit or loss to the *client* arising out of *closing out* that position (a difference account);
  - (2) for the exercise of an *option*:
    - (a) the date of exercise, and either the time of exercise or that the *client* will be notified of that time on request;
    - (b) whether the exercise creates a sale or purchase in the underlying asset; and
    - (c) the strike price of the *option* (for a currency *option*, the rate of exchange will be the same as the strike price) and, if applicable, the total consideration from or to the *client*; and
  - (3) the fact that the transaction involves any dividend or capitalisation or other right which has been declared, but which has not been paid, allotted or otherwise become effective in respect of the *investment*, and under the terms of the transaction the benefit of which will not pass to the purchaser.

#### Guidance on the requirements

- 16A.3.3 G Where a *firm* executes an order in tranches, the *firm* may, where appropriate, indicate the trading time and the execution venue in a way that is consistent with this, such as, "multiple". In accordance with the *client's best interests rule*, a *firm* should provide additional information at the *client's* request.
- 16A.3.4 G In accordance with *COBS 2.4.9R*, a *firm* may dispatch confirmation to an agent, other than the *firm* or an *associate* of the *firm*, nominated by the



*client* in writing.

Reporting obligations in respect of eligible counterparties

16A.3.5	EU	61	The requirements applicable to reports for <i>retail</i> and <i>professional clients</i> under Articles 49 and 59 shall apply unless <i>investment firms</i> enter into agreements with <i>eligible counterparties</i> to determine content and timing of reporting.
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[**Note:** article 61 of the *MiFID Org Regulation*]

#### 16A.4 Periodic reporting

Provision by a firm and contents

16A.4.1	EU	60(1)	Investment firms which provide the service of portfolio management to clients shall provide each such client with a periodic statement in a durable medium of the portfolio management activities carried out on behalf of that client unless such a statement is provided by another person.
		60(2)	<p>The periodic statement required under paragraph 1 shall provide a fair and balanced review of the activities undertaken and of the performance of the portfolio during the reporting period and shall include, where relevant, the following information:</p> <ul style="list-style-type: none"> <li>(a) the name of the investment firm;</li> <li>(b) the name or other designation of the client's account;</li> <li>(c) a statement of the contents and the valuation of the portfolio, including details of each financial instrument held, its market value, or fair value if market value is unavailable and the cash balance at the beginning and at the end of the reporting period, and the performance of the portfolio during the reporting period;</li> <li>(d) the total amount of fees and charges incurred during the reporting period, itemising at least total management fees and total costs associated with execution, and including, where relevant, a statement that a more detailed breakdown will be provided on request;</li> <li>(e) a comparison of performance during the period covered by the statement with the investment performance benchmark (if any) agreed between the investment firm and the client;</li> <li>(f) the total amount of dividends, interest and other payments received during the reporting period in relation to the</li> </ul>

client's portfolio;

- (g) information about other corporate actions giving rights in relation to financial instruments held in the portfolio;
- (h) for each transaction executed during the period, the information referred to in Article 59(4)(c) to (l) where relevant, unless the client elects to receive information about executed transactions on a transaction-by-transaction basis, in which case paragraph 4 of this Article shall apply.

60(3) The periodic statement referred to in paragraph 1 shall be provided once every three months, except in the following cases:

- (a) where the investment firm provides its clients with access to an online system, which qualifies as a durable medium, where up-to-date valuations of the client's portfolio can be accessed and where the client can easily access the information required by Article 63(2) and the firm has evidence that the client has accessed a valuation of their portfolio at least once during the relevant quarter;
- (b) in cases where paragraph 4 applies, the periodic statement must be provided at least once every 12 months;
- (c) where the agreement between an investment firm and a client for a portfolio management service authorises a leveraged portfolio, the periodic statement must be provided at least once a month.

The exception provided for in point (b) shall not apply in the case of transactions in financial instruments covered by Article 4(1)(44)(c) of, or any of points 4 to 11 of Section C in Annex I to Directive 2014/65/EU.

60(4) Investment firms, in cases where the client elects to receive information about executed transactions on a transaction-by-transaction basis, shall provide promptly to the client, on the execution of a transaction by the portfolio manager, the essential information concerning that transaction in a durable medium.

The investment firm shall send the client a notice confirming the transaction and containing the information referred to in Article 59(4) no later than the first business day following that execution or, where the confirmation is received by the investment firm from a third party, no later than the first business day following receipt of the confirmation from the third party.

The second subparagraph shall not apply where the confirmation would contain the same information as a confirmation that is to be promptly dispatched to the client by another person.

[**Note:** article 60 of the *MiFID Org Regulation*]

- 16A.4.2 G In accordance with *COBS 2.4.9R*, a *firm* may dispatch a *periodic statement* (as required by article 60(1) of the *MiFID Org Regulation*, see *COBS 16A.4.1EU*) to an agent, other than the *firm* or an *associate* of the *firm*, nominated by the *client* in writing.

Additional reporting obligations for portfolio management or contingent liability transactions

- 16A.4.3 EU 62(1) Investment firms providing the service of portfolio management shall inform the client where the overall value of the portfolio, as evaluated at the beginning of each reporting period, depreciates by 10% and thereafter at multiples of 10%, no later than the end of the business day in which the threshold is exceeded or, in a case where the threshold is exceeded on a non-business day, the close of the next business day.
- 62(2) Investment firms that hold a retail client account that includes positions in leveraged financial instruments or contingent liability transactions shall inform the client, where the initial value of each instrument depreciates by 10% and thereafter at multiples of 10%. Reporting under this paragraph should be on an instrument-by-instrument basis, unless otherwise agreed with the client, and shall take place no later than the end of the business day in which the threshold is exceeded or, in a case where the threshold is exceeded on a non-business day, the close of the next business day.

[**Note:** article 62 of the *MiFID Org Regulation*]

- 16A.4.4 G For the purposes of this section, a contingent liability transaction should be understood as being a transaction that involves any actual or potential liability for the *client* that exceeds the cost of acquiring the instrument.

[**Note:** recital 96 to the *MiFID Org Regulation*]

Guidance on contingent liability transactions

- 16A.4.5 G When providing a *periodic statement* to a *retail client*, a *firm* should consider whether to include:
- (1) the *collateral* value in respect of any contingent liability transaction in the *client's* portfolio during the relevant period; and
  - (2) *option* account valuations in respect of each open *option* written by the *client* in the *client's* portfolio at the end of the relevant period; stating:
    - (a) the *share, future*, index or other *investment* involved;

- (b) the trade price and date for the opening transaction, unless the valuation statement follows the statement for the period in which the option was opened;
  - (c) the market price of the contract; and
  - (d) the exercise price of the contract.
- (3) *Option* account valuations may show an average trade price and market price in respect of an *option* series if the *client* buys a number of contracts within the same series.

**16A.5 Statements of client financial instruments or client funds**

16A.5.1	EU	<p>63(1) Investment firms that hold client financial instruments or client funds shall send at least on a quarterly basis, to each client for whom they hold financial instruments or funds, a statement in a durable medium of those financial instruments or funds unless such a statement has been provided in any other periodic statement. Upon client request, firms shall provide such statement more frequently at a commercial cost.</p> <p>The first subparagraph shall not apply to a credit institution authorised under Directive 2000/12/EC in respect of deposits within the meaning of that Directive held by that institution.</p> <p>63(2) The statement of client assets referred to in paragraph 1 shall include the following information:</p> <ul style="list-style-type: none"> <li>(a) details of all the financial instruments or funds held by the investment firm for the client at the end of the period covered by the statement;</li> <li>(b) the extent to which any client financial instruments or client funds have been the subject of securities financing transactions;</li> <li>(c) the extent of any benefit that has accrued to the client by virtue of participation in any securities financing transactions, and the basis on which that benefit has accrued;</li> <li>(d) a clear indication of the assets or funds which are subject to the rules of Directive 2014/65/EU and its implementing measures and those that are not, such as those that are subject to Title Transfer Collateral Agreement;</li> <li>(e) a clear indication of which assets are affected by some peculiarities in their ownership status, for instance due to a</li> </ul>
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security interest;

- (f) the market or estimated value, when the market value is not available, of the financial instruments included in the statement with a clear indication of the fact that the absence of a market price is likely to be indicative of a lack of liquidity. The evaluation of the estimated value shall be performed by the firm on a best effort basis.

In cases where the portfolio of a client includes the proceeds of one or more unsettled transactions, the information referred to in point (a) may be based either on the trade date or the settlement date, provided that the same basis is applied consistently to all such information in the statement.

The periodic statement of client assets referred to in paragraph 1 shall not be provided where the investment firm provides its clients with access to an online system, which qualifies as a durable medium, where up-to-date statements of client's financial instruments or funds can be easily accessed by the client and the firm has evidence that the client has accessed this statement at least once during the relevant quarter.

- 63(3) Investment firms which hold financial instruments or funds and which carry out the service of portfolio management for a client may include the statement of client assets referred to in paragraph 1 in the periodic statement it provides to that client pursuant to Article 60(1).

[**Note:** article 63 of the *MiFID Org Regulation*]

- 16A.5.2 G *Firms* subject to either or both the *custody chapter* and the *client money chapter* are reminded of the reporting obligations to *clients* in *CASS 9.2* (Prime broker's daily report to clients) and *CASS 9.5* (Reporting to clients on request).

Amend the following as shown.

## 18 Specialist regimes

...

### 18.2 Energy market activity and oil market activity

...

Energy market activity and oil market activity – non-MiFID business

18.2.3 R ...

COBS	Description
...	
11.8	Recording telephone conversations and electronic communications
...	

...

### 18.3 Corporate finance business

... Corporate finance business – MiFID business

18.3.1 R ...

COBS	Description
...	
11.8	Recording telephone conversations and electronic communications
...	

...

### 18.5 Residual CIS operators, ~~UCITS management companies~~ and small authorised UK AIFMs

Application

18.5.1 R Subject to *COBS* 18.5.1AR and ~~*COBS* 18.5.1BR~~, this section applies to a *firm* which is:

- (1) ~~a UCITS management company;~~ [deleted]
- (2) ~~a full scope UK AIFM;~~ [deleted]
- (3) a small authorised UK AIFM; or
- (4) a residual CIS operator; ~~or~~
- (5) ~~an incoming EEA AIFM branch.~~ [deleted]

18.5.1A R *COBS* 18.5.3R(2) and *COBS* 18.5.5R to *COBS* 18.5.18E do not apply to a small authorised UK AIFM of an unauthorised AIF which is not a collective investment scheme.

- 18.5.1B R (1) ~~The following apply to a full-scope UK AIFM in relation to its AIF management functions:~~
- ~~(a) COBS 18.5.1R to COBS 18.5.2 AG;~~
  - ~~(b) COBS 18.5.3R;~~
  - ~~(c) COBS 18.5.4AR; and~~
  - ~~(d) COBS 18.5.10AR, except as set out in (2).~~
- (2) ~~COBS 18.5.10AR does not apply to a full-scope UK AIFM of:~~
- ~~(a) a UK ELTIF or an EEA ELTIF; or~~
  - ~~(b) an unauthorised AIF which is not a collective investment scheme.~~
- (3) ~~In addition to (1) and (2), COBS 18.5.4CR to COBS 18.5.4DG apply to a full-scope UK AIFM that is an internally managed AIF. [deleted]~~

Application or modification of general COBS rules

- 18.5.2 R A firm when it is carrying on scheme management activity or, for an AIFM, AIFM investment management functions:
- (1) must comply with the COBS rules specified in the table, as modified by this section; and
  - (2) need not comply with any other rule in COBS.

Table: Application of conduct of business rules

<u>Chapter, section, rule</u>	<u>Small authorised UK AIFM and a residual CIS operator</u>
<u>1 (Application)</u>	<u>Applies</u>
<u>2.1.1R (The client's best interests rule)</u>	<u>Applies</u>
<u>2.3 (Inducements relating to business other than MiFID, equivalent third country or optional exemption business)</u>	<u>Applies</u>
<u>2.3B (Inducements and research)<sup>4</sup></u>	<u>Applies</u>
<u>2.4 (Agent as client and reliance on others)</u>	<u>Applies</u>

<sup>4</sup> The FCA is considering modifications to COBS 2.3B when applied to collective portfolio managers and may consult separately on these.

<u>4.2.1R, 4.2.2G and 4.2.3G (The fair, clear and not misleading rule)</u>	<u>Applies</u>
<u>5.2 (E-commerce)</u>	<u>Applies</u>
<u>11.2A (Best execution)</u>	<u>Applies to a <i>small authorised UK AIFM</i> of an <i>authorised AIF</i>. Applies (as modified by <i>COBS 18.5.4R</i> to <i>COBS 18.5.4-AR</i>) to a <i>small authorised UK AIFM</i> of an <i>unauthorised AIF</i> or <i>residual CIS operator</i></u>
<u>11.3 (Client order handling)</u>	<u>Applies</u>
<u>11 Annex 1EU (Regulatory technical standard 28)</u>	<u>Applies as <i>rules</i></u>
<u>16.3 (Periodic reporting)<sup>5</sup></u>	<u>Applies to a <i>small authorised UK AIFM</i> of an <i>unauthorised AIF</i> which is not a <i>collective investment scheme</i>, as modified by <i>COBS 18.5.4BR</i>. Otherwise does not apply.</u>
<u>18.5 (Residual CIS operators and small authorised UK AIFMs)</u>	<u>Applies</u>
<u>18 Annex 1 (Research and inducements for collective portfolio managers)</u>	<u>Applies</u>
<u>18 Annex 2 (Record keeping: client orders and transactions)</u>	<u>Applies</u>

- 18.5.2-A G For activities carried on by *firms* which are not *scheme management activities* or, for an *AIFM*, *AIFM investment management functions*, the *COBS* rules apply under the general application rule, as modified in *COBS 1 Annex 1*.

Table: Application of conduct of business rules

This table belongs to *COBS 18.5.2R* [deleted]

<b>Chapter, section, rule</b>	<b><i>Full-scope UK AIFM</i></b>	<b><i>Small authorised UK AIFM and a residual CIS operator</i></b>	<b><i>Incoming EEA AIFM branch</i></b>	<b><i>UCITS management company</i></b>

<sup>5</sup> The FCA is considering the amendments proposed in this Consultation Paper to *COBS 16.3* and how these should be applied to a small authorised UK AIFM of an unauthorised AIF which is not a collective investment scheme.



1	Applies	Applies	Applies	Applies
2.1.1	Does not apply	Applies	Does not apply	Applies
2.1.4	Applies	Does not apply	Applies	Does not apply
2.3	Does not apply	Applies	Does not apply	Applies
2.4	Does not apply	Applies	Does not apply	Applies
4.2.1–4.2.3	Applies	Applies	Applies	Applies
5.2	Applies	Applies	Applies	Applies
6.1G.2	Applies	Applies	Applies	Applies
11.2	Applies as modified by <i>COBS</i> 18.5.4AR	Applies to a <i>small authorised UK AIFM</i> of an <i>authorised AIF</i> . Applies (as modified by <i>COBS</i> 18.5.4R) to a <i>small authorised UK AIFM</i> of an <i>unauthorised AIF</i> or <i>residual CIS operator</i>	Applies as modified by <i>COBS</i> 18.5.4AR	Applies
11.3	Does not apply	Applies	Does not apply	Applies
11.5	Does not apply	Applies as <i>rules</i>	Does not apply	Does not apply
11.6	Applies, but as modified by <i>COBS</i> 18.5.4CR for <i>internally managed AIFs</i> .	Applies	Applies	Applies
11.8	Applies	Applies	Applies	Applies
16.3	Does not apply	Applies to a <i>small</i>	Does not	Does not apply

		<i>authorised UK AIFM of an unauthorised AIF which is not a collective investment scheme, as modified by COBS 18.5.4BR. Otherwise does not apply.</i>	apply	
18.5	Applies as modified by <i>COBS 18.5.1BR</i>	Applies	Applies	Applies

18.5.2-B G (1) For activities which are not *scheme management activity* or, for an *AIFM*, *AIFM investment management functions*, the *COBS rules* apply under the general application rule, as modified in *COBS 1 Annex 1*.

(2) This may include, for example, activities relating to the administration of the *fund* and *marketing*.

~~Additional application of COBS rules for management companies~~

18.5.2A R ~~A *management company* must:~~

(1) ~~in addition to complying with the *COBS rules* specified in *COBS 18.5.2R*, comply with *COBS 11.7 (Personal account dealing)*; and~~

(2) ~~comply with *COBS 2.3 (Inducements)* as modified by *COBS 2.3.2AR [deleted]*~~

~~[**Note:** article 13(1) to 13(4) of the *UCITS implementing Directive*]~~

~~General modifications<sup>6</sup>~~

18.5.3 R Where *COBS rules* specified in the table in *COBS 18.5.2R* apply to a *firm* carrying on *scheme management activities activity* or, for an *AIFM*, *AIFM investment management functions*, the following modifications apply:

(1) subject to (2), references to *customer* or *client* are to be construed as references to any *fund* in respect of which the *firm* is acting or intends to act, and with or for the benefit of which the relevant activity is to be carried on;

<sup>6</sup> The FCA proposes to consult separately on any additional modifications that are needed as a consequence of the changes to this section (and to COBS 18.5A and COBS 18.5B).

- (2) ~~in the case of a *small authorised UK AIFM* of an *unauthorised AIF* or a *residual CIS operator*, when a *firm* is required by the ~~rules~~ rules in *COBS* to provide information to, or obtain consent from, a *customer* or *client*, the *firm* must ensure that the information is provided to, or consent obtained from, an investor or a potential investor in the *fund* as the case may be;~~
- (3) ~~references to the service of *portfolio management* in *COBS* 11.2A (Best execution); and 11.3 (Client order handling) and *COBS* 11.5 (Record keeping: client orders and transactions) are to be read as references to the management by a *firm* of *financial instruments* held for or within the *fund*; and .~~
- (4) ~~references to *investment firm* in *COBS* 11.5 are to be read as references to *small authorised UK AIFM* or *residual CIS operator*.  
[deleted]~~

- 18.5.3A    G    (1)    *COBS* 1.2 (Markets in Financial Instruments Directive) contains modifications to the text of the *MiFID Org Regulation* where this is applied as *rules* to *firms* that are not subject to those provisions directly.
- (2)    These modifications apply to the following sections that are applied in the table in *COBS* 18.5.2R:
- (a)    *COBS* 11.2A (Best execution);
  - (b)    *COBS* 11.3 (Client order handling); and
  - (c)    *COBS* 11 Annex 1EU (Regulatory technical standard 28).

Research and inducements

- 18.5.3B    R    A *firm* must comply with *COBS* 18 Annex 1 (Research and inducements for collective portfolio managers) when *executing* orders that relate to *financial instruments* for, or on behalf of, the *fund*.

Modification of best execution

- 18.5.4    R    The best execution provisions in *COBS* 11.2A (Best execution) applying do not apply to a *small authorised UK AIFM* of an *unauthorised AIF* or a *residual CIS operator* ~~do not apply in relation to~~ of a *fund* whose fund documents include a statement that best execution does not apply in relation to the *fund* and in which:
- (1)    no investor is a *retail client*; or
  - (2)    no current investor in the *fund* was a *retail client* when it invested in the *fund*.
- 18.5.4-A    R    Where the best execution provisions in *COBS* 11.2A (Best execution)

apply, the following modifications for UCITS management companies also apply to small authorised UK AIFMs of an unauthorised AIF and residual CIS operators:

- (1) COBS 11.2A.9R;
- (2) COBS 11.2A.11R;
- (3) COBS 11.2A.26R; and
- (4) COBS 11.2A.37R.

COBS 11.2A.45R to COBS 11.2A.49G do not apply to a small authorised UK AIFM of an unauthorised AIF and residual CIS operator.

18.5.4A R ~~Only the following provisions in COBS 11.2 apply to a full scope UK AIFM:~~

- ~~(1) COBS 11.2.5G;~~
- ~~(2) COBS 11.2.17G;~~
- ~~(3) COBS 11.2.23AR, but references to management company should be read as references to an AIFM and references to unitholders read as references to investors. This obligation only applies for the execution policy required under article 27(3) of the AIFMD level 2 regulation (Execution of decisions to deal on behalf of the managed AIF);~~
- ~~(4) COBS 11.2.24R;~~
- ~~(5) COBS 11.2.25R(1) and COBS 11.2.26R, but only where an AIF itself has a governing body which can provide prior consent; and~~
- ~~(6) COBS 11.2.27R, but only regarding the obligation on an AIFM to notify the AIF of any material changes to their order execution arrangements or execution policy. [deleted]~~

Modification of periodic reporting requirements<sup>7</sup>

18.5.4B R A small authorised UK AIFM of an unauthorised AIF which is not a collective investment scheme must comply with COBS 16.3 (Periodic reporting) with references to managing investments to be construed as providing AIFM investment management functions.

Modification of dealing commission rules for internally managed AIFs

18.5.4C R ~~Only COBS 11.6.1G to COBS 11.6.11G apply to a full scope UK AIFM that is an internally managed AIF and references to an investment~~

<sup>7</sup> The FCA is considering the amendments proposed in this Consultation Paper to COBS 16.3 and how these should be applied to a small authorised UK AIFM of an unauthorised AIF which is not a collective investment scheme.

~~manager in COBS 11.6 are to be read as including an internally managed AIF which manages designated investments on its own account and references to a customer order as a decision by an internally managed AIF to execute a transaction for these purposes. [deleted]~~

- 18.5.4D G ~~To be an investment manager, a person needs to manage designated investments on a discretionary or non-discretionary basis under the terms of a management agreement. The purpose of COBS 18.5.4CR is to modify COBS 11.6.1G to COBS 11.6.11G so that these provisions apply to a full-scope UK AIFM that is an internally managed AIF because such firms manage designated investments on their own account rather than under the terms of a management agreement. [deleted]~~

...

#### Adequate information

- 18.5.10 E (1) In order to provide adequate information to describe how the *fund* is governed, a *small authorised UK AIFM* of an *unauthorised AIF* or a *residual CIS operator* should include in the fund documents a provision about each of the items of relevant information set out in the following table (Content of fund documents).
- (2) Compliance with (1) may be relied on as tending to establish compliance with COBS 18.5.5R.
- (3) Contravention of (1) may be relied on as tending to establish contravention of COBS 18.5.5R.

Table: Content of fund documents

#### Content of fund documents

The fund documents should include provision about:	
...	
(16)	<del>Use of dealing commission</del> <u>Research and inducements</u> if the <i>firm</i> receives goods or services in addition to the <i>execution</i> of its <i>customer orders</i> in accordance with the section on the use of dealing commission, the prior disclosure required by the <i>rule</i> on prior disclosure (see COBS 11.6.2R) <u>how the <i>firm</i> intends to pay for research</u> . For example, whether the <i>firm</i> proposes to pay for <i>research</i> directly or to use a <i>research</i> payment account;
...	

Application of COBS 18.5.10E to a full-scope UK AIFM

- 18.5.10 R ~~A full-scope UK AIFM which markets an unauthorised AIF to a retail client must, in addition to providing the information in FUND 3.2, take~~

A reasonable steps to offer and, if requested, provide to that potential investor information about the following items in the *COBS 18.5.10E* table (content of fund documents): [deleted]

- (1) ~~(1) (Regulator);~~
- (2) ~~(4) (Commencement);~~
- (3) ~~(5) (Accounting);~~
- (4) ~~(6) (Termination method);~~
- (5) ~~(7) (Complaints procedure);~~
- (6) ~~(8) (Compensation);~~
- (7) ~~(13) (Exchange rates);~~
- (8) ~~(14) (Stabilised investments);~~
- (9) ~~(16) (Use of dealing commission);~~
- (10) ~~(17) (Acting as principal);~~
- (11) ~~(23) (Underwriting commitments);~~
- (12) ~~(24) (Investments in other funds); and~~
- (13) ~~(25) (Investments in securities underwritten by the firm).~~

...

Insert the following new sections after COBS 18.5 (Residual CIS operators and small authorised UK AIFMs). The text is new and is not underlined.

**18.5A Full-scope AIFMs and incoming EEA AIFM branches**

Application

18.5A.1 R Subject to *COBS* 18.5A.2R, this section applies to a *firm* which is:

- (1) a *full-scope UK AIFM* of:
  - (a) a *UK AIF*;
  - (b) an *EEA AIF*; and
  - (c) a *non-EEA AIF*; or
- (2) an *incoming EEA AIFM branch*.

18.5A.2 R *COBS* 18.5A.11R does not apply to a *full-scope UK AIFM* of:

- (1) a *UK ELTIF* or an *EEA ELTIF*; or
- (2) an *unauthorised AIF* which is not a *collective investment scheme*.

Application or modification of general COBS rules

18.5A.3 R A *firm* when it is carrying *AIFM investment management functions*:

- (1) must comply with the *COBS rules* specified in the table, as modified by this section; and
- (2) need not comply with any other *rule* in *COBS*.

Table: Application of conduct of business rules

Chapter, section, rule	Full-scope UK AIFM	Incoming EEA AIFM branch
1 (Application)	Applies	Applies
2.1.4R (AIFMs best interest rule)	Applies	Applies
2.3B (Inducements and research) <sup>8</sup>	Applies	Applies
4.2.1R, 4.2.2G and	Applies	Applies

<sup>8</sup> The FCA is considering modifications to COBS 2.3B when applied to collective portfolio managers and may consult separately on these.

4.2.3G (The fair, clear and not misleading rule)		
5.2 (E-commerce)	Applies	Applies
11.2A (Best execution)	Applies as modified by <i>COBS</i> 18.5A.8R	Applies as modified by <i>COBS</i> 18.5A.8R
11 Annex 1EU (Regulatory technical standard 28)	Applies as <i>rules</i>	Applies as <i>rules</i>
18.5A (Full-scope AIFMs and incoming EEA AIFM branches)	Applies as modified by <i>COBS</i> 18.5A.2R	Applies
18 Annex 1 (Research and inducements for collective portfolio managers)	Applies	Applies

- 18.5A.4 G (1) For activities that are not *AIFM investment management functions*, the *COBS rules* apply under the general application rule, as modified in *COBS* 1 Annex 1.
- (2) This may include, for example, activities relating to the administration of the *AIF*, *marketing* and activities related to the assets of the *AIF*.

#### General modifications

- 18.5A.5 R Where *COBS rules* specified in the table in *COBS* 18.5A.3R apply to a *firm* carrying on *AIFM investment management functions*, the following modifications apply:
- (1) subject to (2), references to *customer* or *client* are to be construed as references to any *AIF* for which the *firm* is acting or intends to act, and with or for the benefit of which the relevant activity is to be carried on; and
- (2) references to the service of *portfolio management* in *COBS* 11.2A (Best execution) are to be read as references to the management by a *firm* of *financial instruments* held for or within the *AIF*.
- 18.5A.6 G (1) *COBS* 1.2 (Markets in Financial Instruments Directive) contains modifications to the text of the *MiFID Org Regulation* where this is applied as *rules* to *firms* that are not subject to those provisions directly.
- (2) These modifications apply to *COBS* 11 Annex 1EU (Regulatory



technical standard 28).

Research and inducements

- 18.5A.7 R A *firm* must comply with *COBS* 18 Annex 1 (Research and inducements for collective portfolio managers) when *executing* orders that relate to *financial instruments* for, or on behalf of, the *fund*.

Modification of best execution

- 18.5A.8 R Only the following provisions in *COBS* 11.2A apply:
- (1) *COBS* 11.2A.16G;
  - (2) *COBS* 11.2A.18G;
  - (3) *COBS* 11.2A.32R(2), but references to *management company* should be read as references to an *AIFM* and references to *unitholders* read as references to investors. This obligation only applies for the execution policy required under article 27(3) of the *AIFMD level 2 regulation* (Execution of decisions to deal on behalf of the managed AIF);
  - (4) *COBS* 11.2A.35R(1);
  - (5) *COBS* 11.2A.34R(1) and *COBS* 11.2A.35R(2) and (3), but only where an *AIF* itself has a governing body which can provide prior consent; and
  - (6) *COBS* 11.2A.52R (and the associated requirements of *COBS* 11 Annex 1EU, which applies as *rules* as a result of *COBS* 18.5A.3R).
- 18.5A.9 R In addition, an *AIFM* must notify the *AIF* of any material changes to their order execution arrangements or execution policy.

Distance marketing

- 18.5A.10 G *Firms* should also be aware that if they are carrying on distance marketing activity from an establishment in the *UK*, with or for a *consumer* in the *UK* or another *EEA State*, *COBS* 5.1 applies specific requirements for that activity.

Adequate information

- 18.5A.11 R A *full-scope UK AIFM* which *markets* an *unauthorised AIF* to a *retail client* must, in addition to providing the information in *FUND* 3.2, take reasonable steps to offer and, if requested, provide to that potential investor information about the following items:
- (1) regulator – the *firm*'s statutory status in accordance with *GEN* 4 Annex 1R (Statutory status disclosure);

- (2) commencement – when and how the *firm* is appointed;
- (3) accounting – the arrangements for accounting to the *AIF* or investors in the *AIF* for any transaction effected;
- (4) termination method – how the appointment of the *firm* may be terminated;
- (5) complaints procedure – how to complain to the *firm* and a statement that the investors in the *AIF* may subsequently complain directly to the *Financial Ombudsman Service*;
- (6) compensation – whether or not compensation may be available from the *compensation scheme* should the *firm* be unable to meet its liabilities, and information about any other applicable compensation scheme; and for each applicable compensation scheme, the extent and level of cover and how further information can be obtained;
- (7) exchange rates – if a liability of the *AIF* in one currency is to be matched by an asset in a different currency, or if the services to be provided to the *firm* for the *AIF* may relate to an *investment* denominated in a currency other than the currency in which the *investments* of the *AIF* are valued, a warning that a movement of exchange rates may have a separate effect, unfavourable or favourable, on the gain or loss otherwise made on the *investments* of the *AIF*;
- (8) stabilised investments – if it is the case that the *firm* will have the right under the *AIF documents* to effect transactions in *investments*, the prices of which may be the subject of stabilisation;
- (9) research and inducements – how the *firm* intends to pay for *research*. For example, whether the *firm* proposes to pay for *research* directly or to use a *research* payment account;
- (10) acting as principal – if it is the case that the *firm* may act as *principal* in a transaction with the *AIF*;
- (11) underwriting commitments – if it is the case that the *firm* may for the account of the portfolio of the *AIF* underwrite or sub-underwrite any issue or offer for sale of *securities*, and:
  - (a) whether there are any restrictions on the categories of *securities* which may be underwritten and, if so, what these restrictions are; and
  - (b) whether there are any financial limits on the extent of the underwriting and, if so, what these limits are;
- (12) investments in other funds – whether or not the portfolio may invest in *funds* either managed or advised by the *firm* or by an *associate* of

the *firm* or in a *fund* which is not a *regulated collective investment scheme*; and

- (13) investments in securities underwritten by the *firm* – whether or not the portfolio may contain *securities* of which any issue or offer for sale was underwritten, managed or arranged by the *firm* or by an *associate* of the *firm* during the preceding 12 *months*.

## 18.5B UCITS management companies

Application

- 18.5B.1 R This section applies to a *UCITS management company*.

Application or modification of general COBS rules

- 18.5B.2 R A *firm* when it is carrying on *scheme management activity*:

- (1) must comply with the *COBS rules* specified in the table, as modified by this section; and
- (2) need not comply with any other *rule* in *COBS*.

Table: Application of conduct of business rules

Chapter, section, rule	UCITS management company
1 (Application)	Applies
2.1.1 (The client's best interests rule)	Applies
2.3 (Inducements relating to business other than MiFID, equivalent third country or optional exemption business)	Applies, as modified by <i>COBS</i> 2.3.1AR and <i>COBS</i> 2.3.2AR
2.3B (Inducements and research) <sup>9</sup>	Applies
2.4 (Agent as client and reliance on others)	Applies
4.2.1R, 4.2.2G and 4.2.3G (The fair, clear and not misleading rule)	Applies
5.2 (E-commerce)	Applies
11.2A (Best execution)	Applies

<sup>9</sup> The FCA is considering modifications to COBS 2.3B when applied to collective portfolio managers and may consult separately on these.

11.3 (Client order handling)	Applies
11.7 (Personal account dealing)	Applies
11 Annex 1EU (Regulatory technical standard 28)	Applies as <i>rules</i>
18.5B (UCITS management companies)	Applies
18 Annex 1 (Research and inducements for collective portfolio managers)	Applies

- 18.5B.3 G (1) For activities which are not *scheme management activity* the *COBS rules* apply under the general application rule, as modified in *COBS 1 Annex 1*.
- (2) This may include, for example, activities relating to the administration of the *UCITS* and *marketing*.

General modifications

- 18.5B.4 R Where *COBS rules* specified in the table in *COBS 18.5B.2R* apply to a *firm* carrying on *scheme management activities*, the following modifications apply:
- (1) subject to (2), references to *customer* or *client* are to be construed as references to any *scheme* in respect of which the *firm* is acting or intends to act, and with or for the benefit of which the relevant activity is to be carried on; and
- (2) references to the service of *portfolio management* in *COBS 11.2A* (Best execution) and *COBS 11.3* (Client order handling) are to be read as references to *collective portfolio management*.
- 18.5B.5 G (1) *COBS 1.2* (Markets in Financial Instruments Directive) contains modifications to the text of the *MiFID Org Regulation* where this is applied as *rules to firms* that are not subject to those provisions directly.
- (2) These modifications apply to the following sections that are applied in the table in *COBS 18.5B.2R*:
- (a) *COBS 11.2A* (Best execution);
- (b) *COBS 11.3* (Client order handling); and
- (c) *COBS 11 Annex 1EU* (Regulatory technical standard 28).

Research and inducements

- 18.5B.6 R A *firm* must comply with *COBS 18 Annex 1* (Research and inducements for collective portfolio managers) when *executing* orders that relate to

*financial instruments* for, or on behalf of, the *fund*.

Distance marketing

- 18.5B.7 G *Firms* should also be aware that if they are carrying on distance marketing activity from an establishment in the *UK*, with or for a *consumer* in the *UK* or another *EEA State*, *COBS 5.1* applies specific requirements for that activity.

Amend the following as shown. Underlining indicates new text and striking through indicates deleted text.

## 18.9 ICVCs

...

- 18.9.2 G *Firms* should note that the *operator* of an *ICVC* when it is undertaking *scheme management activity* will be subject to:
- (1) *COBS 18.5.2R* if the *operator* is a *small authorised UK AIFM*; or
  - (2) *COBS 18.5A.3R* if the *operator* is a *full-scope UK AIFM* or an *incoming EEA AIFM branch*; or
  - (3) *COBS 18.5B.2R* if the *operator* is a *UCITS management company*.

Insert the following Annexes to COBS 18. The text is new and is not underlined.

### 18 Annex 1 Research and inducements for collective portfolio managers

1	Application	
1.1	G	This section applies to:
	(1)	a <i>small authorised UK AIFM</i> and a <i>residual CIS operator</i> , in accordance with <i>COBS 18.5.2R</i> ;
	(2)	a <i>full-scope UK AIFM</i> and an <i>incoming EEA AIFM branch</i> , in accordance with <i>COBS 18.5A.3R</i> ;
	(3)	a <i>UCITS management company</i> , in accordance with <i>COBS 18.5B.2R</i> .
2	Rule on research and inducement	
2.1	R	When <i>executing</i> orders that relate to <i>financial instruments</i> for, or on behalf of, the <i>fund</i> , a <i>firm</i> must not:

		(1)	accept and retain any fees, commissions or monetary benefits; or
		(2)	accept any non-monetary benefits,
			where these are paid or provided by any third party or a <i>person</i> acting on behalf of a third party.
2.2	R	A <i>firm</i> must:	
		(1)	return to the <i>fund</i> as soon as reasonably possible after receipt any fees, commissions or any monetary benefits paid or provided by any third party or a <i>person</i> acting on behalf of a third party in relation to the services provided to that <i>fund</i> ; and
		(2)	inform the investors in the <i>fund</i> about the fees, commissions or any monetary benefits transferred to them (see paragraph 2.4G).
2.3	G	Paragraph 2.2R does not apply to:	
		(1)	minor non-monetary benefits that are:
		(a)	capable of enhancing the quality of service provided to the <i>fund</i> (see paragraph 3.1R); and
		(b)	of a scale and nature such that they could not be judged to impair the <i>firm's</i> compliance with its duty to act honestly, fairly and professionally in the best interests of the <i>fund</i> ; and
		(2)	<i>research</i> if the requirements of COBS 2.3B <sup>10</sup> (Inducements and research) are met.
2.4	G	A <i>firm</i> may inform investors in the <i>fund</i> about the fees, commissions or monetary benefits transferred to them through:	
		(1)	the periodic reporting statements provided to <i>participants</i> in an <i>unregulated collective investment scheme</i> in accordance with COBS 18.5.11R for a <i>small authorised UK AIFM</i> or a <i>residual CIS operator</i> ; or
		(2)	the annual reports provided on request to investors, for a <i>small authorised UK AIFM</i> in relation to an <i>authorised AIF</i> , a <i>full-scope UK AIFM</i> , an <i>incoming EEA AIFM branch</i> or a <i>UCITS management company</i> .
3	Acceptable minor non-monetary benefits		
3.1	R	A <i>firm</i> must not accept a non-monetary benefit unless it is a minor non-monetary benefit which is reasonable, proportionate and of a scale that is unlikely to influence the <i>firm's</i> behaviour in any way that is detrimental to the	

<sup>10</sup> The FCA is considering modifications to COBS 2.3B when applied to collective portfolio managers and may consult separately on these.

		interests of the <i>fund</i> , and which consists of:	
		(1)	information or documentation relating to a <i>financial instrument</i> , that is generic in nature;
		(2)	written material from a third party:
		(a)	that is either:
		(i)	commissioned and paid for by a corporate <i>issuer</i> or potential <i>issuer</i> to promote a new issuance by the company; or
		(ii)	produced on an ongoing basis, where the third party <i>firm</i> is contractually engaged and paid by the <i>issuer</i> ;
		(b)	provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any <i>firm</i> wishing to receive it, or to the general public;
		(3)	participation in conferences, seminars and other training events on the benefits and features of a specific <i>financial instrument</i> ; and
		(4)	hospitality of a reasonable de minimis value, such as food and drink during a business meeting or another training event mentioned under (3).
3.2		Information or documentation relating to a <i>financial instrument</i> is an acceptable minor non-monetary benefit if it:	
		(1)	consists of:
		(a)	short term market commentary on the latest economic statistics; or
		(b)	company results or information on upcoming releases or events;
		(2)	is provided by a third party;
		(3)	contains only a brief unsubstantiated summary of the third party's own opinion on such information; and
		(4)	does not include any substantive analysis (for example, where the third party simply reiterates a view based on an existing recommendation or substantive research).
3.3	G	A non-monetary benefit that involves a third party allocating valuable resources to the <i>firm</i> is not a minor non-monetary benefit.	

## 18 Annex 2 Record keeping: client orders and transactions

1	Application		
1.1	G	This section applies to:	
		(1)	<i>a firm</i> in respect of non- <i>MiFID</i> business related to commodity derivative instruments, in accordance with <i>COBS</i> 18.2.5R;
		(2)	<i>a small authorised UK AIFM</i> and a <i>residual CIS operator</i> , in accordance with <i>COBS</i> 18.5.2R;
		(3)	an <i>OPS firm</i> when it carries on business which is not <i>MiFID</i> or <i>equivalent third country business</i> , in accordance with <i>COBS</i> 18.8.1R; and
		(4)	an <i>authorised professional firm</i> with respect to activities other than <i>non-mainstream regulated activities</i> , in accordance with <i>COBS</i> 18.11.1R.
2	Record keeping of client orders and decisions to deal		
2.1	R	(1)	A <i>firm</i> must immediately make a record of the details in (2), to the extent they are applicable to the order or decision to deal in question, in relation to:
		(a)	every order received from a <i>client</i> ;
		(b)	every decision to deal taken in providing the service of <i>portfolio management</i> ; and
		(c)	for a <i>small authorised UK AIFM</i> and <i>residual CIS operator</i> , every decision to deal taken in managing <i>financial instruments</i> held for or within a <i>fund</i> .
		(2)	The details referred to in (1) are:
		(a)	the name or other designation of the <i>client</i> ;
		(b)	the name or other designation of any relevant <i>person</i> acting on behalf of the <i>client</i> ;
		(c)	the details specified in points (3), (4), and in points (5) to (8), of the table in 4.1;
		(d)	the nature of the order if other than buy or sell;
		(e)	the type of the order;
		(f)	any other details, conditions and particular instructions from the <i>client</i> that specify how the order must be carried out; and



		(g)	the date and exact time of the receipt of the order, or of the decision to deal by the <i>firm</i> .	
3	Record-keeping of transactions			
3.1	R	Immediately after executing a <i>client</i> order, or, in the case of <i>firms</i> that transmit orders to another <i>person</i> for <i>execution</i> , immediately after receiving confirmation that an order has been <i>executed</i> , <i>firms</i> must record the following details of the transaction in question:		
		(1)	the name or other designation of the <i>client</i> ;	
		(2)	the details specified in points (1) to (10) of the table in 4.1R;	
		(3)	the total price, being the product of the unit price and the quantity;	
		(4)	the nature of the transaction if other than buy or sell; and	
		(5)	the natural <i>person</i> who <i>executed</i> the transaction or who is responsible for the <i>execution</i> .	
3.2	R	If a <i>firm</i> transmits an order to another <i>person</i> for <i>execution</i> , the <i>firm</i> must immediately record the following details after making the transmission:		
		(1)	the name or other designation of the <i>client</i> whose order has been transmitted;	
		(2)	the name or other designation of the <i>person</i> to whom the order was transmitted;	
		(3)	the terms of the order transmitted; and	
		(4)	the date and exact time of transmission.	
4	Details to be recorded			
4.1	R	(1)	Trading day	The trading day on which the transaction was executed.
		(2)	Trading time	The time at which the transaction was executed, reported in the local time of the <i>competent authority</i> to which the transaction will be reported, and the basis in which the transaction is reported expressed as Co-ordinated Universal Time (UTC) +/- hours.
		(3)	Buy/sell indicator	Identifies whether the transaction was a buy or sell from the perspective of the reporting <i>firm</i> or, in the case of a report to a <i>client</i> , of the <i>client</i> .
		(4)	Instrument	This must consist of:

			identification	<p>a unique code to be decided by the <i>competent authority</i> (if any) to which the report is made identifying the <i>financial instrument</i> which is the subject of the transaction; and</p> <p>if the <i>financial instrument</i> in question does not have a unique identification code, the report must include the name of the instrument or, in the case of a <i>derivative</i> contract, the characteristics of the contract.</p>
		(5)	Unit price	The price per <i>security</i> or <i>derivative</i> contract excluding <i>commission</i> and (where relevant) accrued interest. In the case of a debt instrument, the price may be expressed either in terms of currency or as a percentage.
		(6)	Price notation	The currency in which the price is expressed. If, in the case of a bond or other form of securitised debt the price is expressed as a percentage, that percentage must be included.
		(7)	Quantity	The number of units of the <i>financial instruments</i> , the nominal value of bonds, or the number of <i>derivative</i> contracts included in the transaction.
		(8)	Quantity notation	An indication as to whether the quantity is the number of units of <i>financial instruments</i> , the nominal value of bonds or the number of <i>derivative</i> contracts.
		(9)	Counterparty	Identification of the counterparty to the transaction. That identification must consist of:
				(a) where the counterparty is an <i>investment firm</i> , a unique code for that <i>firm</i> , to be determined by the <i>competent authority</i> (if any) to which the report is made; where the counterparty is a <i>regulated market</i> , an <i>MTF</i> or an entity acting as its central counterparty, the unique harmonised identification code for that market, <i>MTF</i> or entity acting as central counterparty, as specified in the list published by the <i>competent authority</i> of the home Member State of that entity;
				(b) where the counterparty is not an <i>investment firm</i> , a <i>regulated market</i> , an <i>MTF</i> or an entity acting as central counterparty, it should be identified as 'customer/client' of the <i>investment firm</i> which executed the

				transaction.
		(10)	Venue identification	<p>Identification of the venue where the transaction was executed.</p> <p>That identification must consist of: where the venue is a <i>trading venue</i>: its unique harmonised identification code; otherwise: the code 'OTC'.</p>

**Sch 1 Record keeping requirements**

...

Sch 1.3G

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...	...	...	...	...
<del>COBS 11.8.5R</del>	Telephone conversations and electronic communications subject to the taping obligation (see <del>COBS 11.8.5R</del> )	Telephone conversations and electronic communications recorded under <del>COBS 11.8.5R</del>	When the conversation or electronic communication is made, sent or received	6 months
...				

**Annex I****Amendments to the Insurance: Conduct of Business sourcebook (ICOBS)**

In this Annex, underlining indicates new text and striking through indicates deleted text.

**2 General matters**

...

**2.4 Record-keeping**

- 2.4.1 G (1) The Senior Management Arrangements, Systems and Controls sourcebook (SYSC) contains high-level record-keeping requirements (see ~~SYSC 3.2.20R~~ and ~~SYSC 9.1.1R~~ and SYSC 9.1.1AR).

...

...

## Annex J

## Amendments to the Client Assets sourcebook (CASS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

## 9 Information to clients

...

### 9.4 Information to clients concerning custody assets and client money

- 9.4.1 G (1) Firms to which COBS 6.1 applies are reminded that, under COBS 6.1.7R, a *firm* that holds *client designated investments* or *client money* must provide its *clients* with specific information about how the *firm* holds those *client designated investments* and *client money* and how certain arrangements might give rise to specific consequences or risks for those *client designated investments* and *client money*.
- (2) COBS 6.1 (Information about the firm and compensation information (excluding MiFID or equivalent third country business and MiFID optional exemption business)) applies to a firm that carries on designated investment business, other than MiFID or equivalent third country business or MiFID optional exemption business, for a retail client.
- 9.4.2 R A firm to which COBS 6.1 applies that holds *custody assets* or *client money* must, in relation to its business for which COBS 6.1 applies:
- ...
- 9.4.2A G (1) Firms to which [COBS 6X.1] applies are reminded of the requirements under article 49 of the MiFID Org Regulation (which are directly applicable to some firms and which are also applied to firms in other circumstances [COBS 6X.1.4R]) to provide certain information to a client when the firm is holding the client's financial instruments or funds (see COBS [6X.2.6EU]).
- (2) [COBS 6X.1 (Information about the firm, its services and remuneration (in relation to MiFID or equivalent third country business and MiFID optional exemption business))] applies to a firm that carries on MiFID or equivalent third country business or MiFID optional exemption business for a client.
- 9.4.2B R A firm to which [COBS 6X.1] applies that holds *custody assets* or *client money* must, in relation to its business for which [COBS 6X.1] applies:
- (1) provide the information referred to in paragraphs 2 to 7 of article 49 of the MiFID Org Regulation for any custody asset that the firm may

hold for a client, including:

(a) any custody asset which is a designated investment but not a financial instrument; and

(b) any custody asset which is neither a designated investment nor a financial instrument; and

(2) provide the information in (1) to each of its clients.

9.4.3 G A firm should provide the information required in CASS 9.4.2R or CASS 9.4.2BR (as applicable) to any client for whom it holds custody assets or client money, including a retail client, a professional client and an eligible counterparty.

9.4.4 G (1) ...

(2) Firms are also reminded of the requirements in respect of communications made to retail clients under COBS 4.5 and clients under article 44 of the MiFID Org Regulation and COBS 4.5A (as applicable).

...

## 9.5 Reporting to clients on request

9.5.1 G (1) Firms to which COBS 16.4 applies are reminded that, under COBS 16.4, they are required to send to each of their clients at least once a year a statement in a durable medium of those designated investments and/or client money they hold for that client. A firm which manages investments may provide this statement in its periodic statement, as required under COBS 16.3.

(2) COBS 16.4 (Statements of client designated investments or client money) applies, in accordance with [COBS 16.1-1R], to a firm carrying on designated investment business other than MiFID or equivalent third country business or MiFID optional exemption business, for a retail client.

9.5.2 G Firms are reminded that the requirements in COBS 16.4, article 63 of the MiFID Org Regulation and COBS 16A.4 only set out the minimum frequency at which firms must report to their clients on their holdings of designated investments and/or client money. Firms may choose to report to their clients more frequently.

9.5.3 G Subject to CASS 9.5.5AR and CASS 9.5.6R, CASS 9.5.4R, CASS 9.5.4BR and CASS 9.5.5R require firms to comply with a client's request for information on the custody assets and/or client money the firm holds for a client under CASS 6 and/or CASS 7, and such request may be made by a client at any time.

- 9.5.4 R When a *firm to which COBS 16.4 applies* receives a request, made by a *client*, or on a *client's* behalf, for a statement of the *custody assets* and/or *client money* that the *firm* holds for that *client*, the *firm* must provide the *client* with the statement requested in a *durable medium*.
- 9.5.4A G (1) *Firms to which [COBS 16A] applies are reminded of the requirements under article 63 of the MiFID Org Regulation (which are directly applicable to some firms and which are also applied to firms in other circumstances under [COBS 16A.1.4R]) in relation to quarterly statements when the firm is holding a client's financial instruments or funds (see COBS [16A.4.1EU]).*
- (2) *[COBS 16A (Reporting information to clients in relation to MiFID or equivalent third country business and MiFID optional exemption business)] applies to a firm that carries on MiFID or equivalent third country business or MiFID optional exemption business for a client.*
- 9.5.4B R *When a firm to which [COBS 16A] applies receives a request, made by a client, or on a client's behalf, for a statement of the custody assets that the firm holds for that client, it must provide the client with a statement in a durable medium in relation to any custody assets that are not financial instruments.*
- 9.5.4C G *A firm to which [COBS 16A] applies may combine the statement required under CASS 9.5.4BR with a statement issued in response to a request made under the last sentence of the first sub-paragraph of article 63(1) of the MiFID Org Regulation.*
- ...
- 9.5.5A R *A firm is not required to provide a client with a statement under CASS 9.5.4R or CASS 9.5.4BR, or a copy of a statement under CASS 9.5.5R (as applicable) where the following conditions are met:*
- (1) *the firm provides the client with access to an online system, which qualifies as a durable medium;*
- (2) *up-to-date statements of the client's custody assets and/or client money can be easily accessed by the client via the system under (1); and*
- (3) *the firm has evidence that the client has accessed this statement at least once during the relevant quarter.*
- 9.5.6 R Any charge agreed between the *firm* and the *client* for providing the statements in *CASS 9.5.4R and, CASS 9.5.4BR or CASS 9.5.5R (as applicable)* must *reasonably correspond to the firm's actual costs* *be at a commercial cost.*
- 9.5.7 G Any statement provided to a *client* under *CASS 9.5.4R or CASS 9.5.5R (as applicable)* may, although it is not required to, be in the same form as the

statement a *firm* is required to provide to a *client* under *COBS* 16.4 or, if appropriate, *COBS* 16.3.

...

- 9.5.9 G *Firms* are reminded that under *CASS* 3.2.4G *firms* that enter into arrangements with ~~retail clients~~ retail clients covered by *CASS* 3 (Collateral) should, when appropriate, identify in any statement of *custody assets* sent to the *client* under *COBS* 16.4 (Statements of client designated investments or client money), article 63 of the *MiFID Org Regulation* or *COBS* 16A.4 (as applicable) or this section, the details of the assets which form the basis of that collateral arrangement.



## Annex K

## Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

### 3 Auditors

...

#### 3.1 Application

...

##### 3.1.2 R Applicable sections (see SUP 3.1.1R)

(1) Category of firm	(2) Sections applicable to the firm	(3) Sections applicable to its auditor
...		
<p>Note 3B = UK MiFID investment firms include exempt CAD firms. An exempt CAD firm that has opted into MiFID can benefit from the audit exemption for small companies in the Companies Act legislation if it meets the relevant criteria in that legislation and fulfils the conditions of regulation 4C(3) 4(8) of the <del>Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2007</del> <u>MiFI Regulations</u>. If a firm does so benefit then SUP 3 will not apply to it. For further details about exempt CAD firms, see PERG 13, Q58.</p>		
...		

...

#### 10A FCA Approved Persons

...

##### 10A.7 FCA required functions

...

Compliance oversight function (CF10)

10A.7.8 R The *compliance oversight function* is the function of acting in the capacity of:

- (1) a *director or senior manager* who is allocated the function set out in ~~SYSC 3.2.8R, SYSC 6.1.4R(2) or SYSC 6.1.4CR; or~~

- (a) SYSC 3.2.8R; or
- (b) SYSC 6.1.4R(2); or
- (c) article 22(3) of the *MiFID Org Regulation* (as applied in accordance with SYSC 1 Annex 1 2.8AR, SYSC 1 Annex 1 3.2-AAAR, SYSC 1 Annex 1 3.2-AAR, SYSC 1 Annex 1 3.2CR and SYSC 1 Annex 1 3.3R); or
- (d) SYSC 6.1.4CR; or

...

...

## 10A.8 Systems and controls functions

Systems and controls function (CF28)

- 10A.8.1 R The *systems and controls function* is the function of acting in the capacity of an *employee* of the *firm* with responsibility for reporting to the *governing body* of a *firm*, or the audit committee (or its equivalent) in relation to:
- (1) its financial affairs;
  - (2) setting and controlling its risk exposure (see SYSC 3.2.10G ~~and~~, SYSC 7.1.6R ~~and~~ article 23(2) of the *MiFID Org Regulation* (as applied in accordance with SYSC 1 Annex 1 2.8AR, SYSC 1 Annex 1 3.2-AAAR, SYSC 1 Annex 1 3.2-AAR, SYSC 1 Annex 1 3.2CR and SYSC 1 Annex 1 3.3R)); and
  - (3) adherence to internal systems and controls, procedures and policies (see SYSC 3.2.16G ~~and~~, SYSC 6.2 ~~and~~ article 23(2) of the *MiFID Org Regulation* (as applied in accordance with SYSC 1 Annex 1 2.8AR, SYSC 1 Annex 1 3.2-AAAR, SYSC 1 Annex 1 3.2-AAR, SYSC 1 Annex 1 3.2CR and SYSC 1 Annex 1 3.3R)).

...

## 10C FCA senior management regime for approved persons in relevant authorised persons

...

### 10C.6 FCA-required functions

Compliance oversight function (SMF16)

- 10C.6.1 R The *compliance oversight function* is the function of acting in the capacity of a *director* or *senior manager* who is allocated the function in:
- (1) SYSC 6.1.4R(2); or

- (2) article 22(3) of the *MiFID Org Regulation* (as applied in accordance with SYSC 1 Annex 1 2.8AR, SYSC 1 Annex 1 3.2-AAAR, SYSC 1 Annex 1 3.2-AAR, SYSC 1 Annex 1 3.2CR and SYSC 1 Annex 1 3.3R).

...

## Annex L

## Amendments to the Decision Procedure and Penalties Manual (DEPP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

## 6 Penalties

...

### 6.2 Deciding whether to take action

...

Action against individuals under section 66 of the Act

...

- 6.2.5 G In some cases it may not be appropriate to take disciplinary measures against a *firm* for the actions of an individual (an example might be where the *firm* can show that it took all reasonable steps to prevent the *breach*). In other cases, it may be appropriate for the *FCA* to take action against both the *firm* and the individual. For example, a *firm* may have breached the *rule* requiring it to take reasonable care to establish and maintain such systems and controls as are appropriate to its business (SYSC 3.1.1R or SYSC 4.1.10R or article 21(5) of the *MiFID Org Regulation* (as applied in accordance with SYSC 1 Annex 1 2.8AR, SYSC 1 Annex 1 3.2-AAAR, SYSC 1 Annex 1 3.2-AAR, SYSC 1 Annex 1 3.2CR and SYSC 1 Annex 1 3.3R), and an individual may have taken advantage of those deficiencies to front run orders or misappropriate assets.

...

## Annex M

## Amendments to the Consumer Credit sourcebook (CONC)

In this Annex, underlining indicates new text and striking through indicates deleted text.

**7 Arrears, default and recovery (including repossessions)**

...

**7.6 Exercise of continuous payment authority**

...

7.6.15 G ...

- (3) *Firms* are reminded of their record-keeping obligations under SYSC 9.1.1R and SYSC 9.1.1AR (~~general~~ **General** rules on record-keeping) which in particular require sufficient records to be kept to ascertain that the *firm* has complied with all obligations with respect to *customers*. These should include, for example, arranging to keep records of payment requests (including refusals of payment requests) made under *continuous payment authorities* and to keep suitable written or other records of the consents referred to in CONC 7.6.1R, CONC 7.6.12R, CONC 7.6.13R and CONC 7.6.14R.

## Annex N

## Product Intervention and Product Governance Sourcebook (PROD)

All text in this Annex is new text and is not underlined.

## 1 Application and purpose

### 1.1 Purpose

- 1.1.1 G The purpose of *PROD* is to improve *firms*' product oversight and governance processes and to set out the *FCA*'s statement of policy on making *temporary product intervention rules*.
- 1.1.2 G Product oversight and governance refers to the systems and controls *firms* have in place to design, approve, market and manage products throughout the products' lifecycle to ensure they meet legal and regulatory requirements.
- 1.1.3 G Good product governance should result in products that:
- (1) meet the needs of one or more identifiable target markets;
  - (2) are sold to *clients* in the target markets by appropriate *distribution channels*; and
  - (3) deliver appropriate *client* outcomes.

### 1.2 Application of PROD 2

- 1.2.1 R *PROD 2* sets out the *FCA*'s approach to issuing *temporary product intervention rules*. It is of relevance to all *firms*.

### 1.3 Application of PROD 3

General: Who? What?

- 1.3.1 R *PROD 3* applies to:
- (1) a *MIFID investment firm*;
  - (2) a *CRD credit institution*;
  - (3) a *MiFID optional exemption firm*; and
  - (4) *branches of third country investment firms*;

with respect to:

- (5) *manufacturing financial instruments and structured deposits*; and
- (6) *distributing financial instruments, structured deposits and investment services*.

[Note: articles 1(3), 1(4), 16(3), 24(2) and 41(2) of *MiFID*]

Other firms manufacturing or distributing financial instruments or structured deposits

- 1.3.2 R Other firms which *manufacture* or *distribute financial instruments or structured deposits* should take account of *PROD 3* as if it were *guidance* on the *Principles* and other relevant *rules* and as if “should” appeared in *PROD 3* rules instead of “must”.

Where?

- 1.3.3 R *PROD 3* applies to a firm with respect to activities carried on from an establishment maintained by it, or its *appointed representative*, in the *United Kingdom*.

- 1.3.4 R (1) *PROD 3* also applies to a firm with respect to activities from an establishment *overseas* with a *client* in the *United Kingdom*.
- (2) But *PROD 3* does not apply to those activities if the office from which the activity is carried on were a separate *person* and the activity:
- (a) would fall within the *overseas persons* exclusions in article 72 of the *Regulated Activities Order*; or
  - (b) would not be regarded as being carried on in the *United Kingdom*.

EEA territorial scope rule: compatibility with European law

- 1.3.5 R (1) The territorial scope of *PROD 3* is modified to the extent necessary to be compatible with European law (see *PROD 1.3.6G-1.3.9G* for guidance on this).
- (2) This *rule* overrides every other *rule* in this sourcebook.

Effects of the EEA territorial scope rule

- 1.3.6 G One of the effects of *PROD 1.3.5R* is to override the application of this sourcebook to the *overseas* establishments of *EEA firms* in circumstances covered by *MiFID*.
- 1.3.7 G The *guidance* in this chapter provides a general overview only and is not

comprehensive.

- 1.3.8 G When considering the impact of a directive on the territorial application of a *rule*, a *firm* will first need to consider whether the relevant situation involves a non-UK element. *PROD* 1.3.5R is unlikely to apply if a *UK firm* is doing business in a *UK establishment* for a *client* located in the *United Kingdom* in relation to a *United Kingdom* product. However, if there is a non-UK element, the *firm* should consider whether:

- (1) it is subject to the directive (in general, directives only apply to *UK firms* and *EEA firms*, but the implementing provisions may not treat non-*EEA firms* more favourably than *EEA firms*);
- (2) the business it is performing is subject to the directive; and
- (3) the particular *rule* is within the scope of the directive.

If the answer to all three questions is ‘yes’, *PROD* 1.3.5R may change the application of the *rules* in this sourcebook.

- 1.3.9 G When considering a particular situation, a *firm* should also consider whether two or more directives apply.

MiFID: effect on territorial scope

- 1.3.10 G *PERG* 13 contains general *guidance* on the *persons* and businesses to which *MiFID* applies.
- 1.3.11 G For a *UK MiFID investment firm*, *rules* in this sourcebook that are within the scope of *MiFID* generally apply to its *MiFID business* carried on from an establishment in the *United Kingdom*. They also generally apply to its *MiFID business* carried on from an establishment in another *EEA State*, but only where that business is not carried on within the territory of that *EEA State*.

[**Note:** see articles 34(1) and 35(1) and (8) of *MiFID*]

- 1.3.12 G For an *EEA MiFID investment firm*, *rules* in this sourcebook that are within the scope of *MiFID* generally apply only to its *MiFID business* if that business is carried on from an establishment in, and within the territory of, the *United Kingdom*.

[**Note:** see articles 35(1) and (8) of *MiFID*]

Electronic Commerce Directive: effect on territorial scope

- 1.3.13 [intentionally blank]

- 1.3.14 G The guidance on the *Electronic Directive* in *COBS* 1 Annex 1, Part 3, paragraph 7 applies equally in relation to the *rules* in *PROD* 3.

Interaction of *PROD* 3 and the RPPD Guide



- 1.3.15 G A *firm* to which *PROD* 3 applies need not apply the *guidance* in *RPPD* for matters covered by *PROD* if the *firm* has complied with *PROD* 3.

## 2 Statement of policy with respect to the making of temporary product intervention rules

[*Editor's note*: This chapter does not take account of any changes that may be required as a result of *MiFIR* or Regulation (EU) 1286/2014 (*PRIIPs*)]

### 2.1 Purpose

- 2.1.1 G This chapter explains the *FCA's* policy with respect to the making of *temporary product intervention rules* under sections 137D and 138M of the *Act*.
- 2.1.2 G Product intervention *rules* are *rules* made under section 137D of the *Act* which apply to specific products (or types of products), product features or marketing practices relating to specific products.
- 2.1.3 G Product intervention *rules* may be made without consultation under section 138M of the *Act* but are limited to a maximum duration of 12 months and are referred to as "*temporary product intervention rules*".

### 2.2 General rule making and product intervention rules

- 2.2.1 G The *Act* empowers the *FCA* to make general *rules* as appear necessary or expedient for the purpose of advancing one or more of its *operational objectives*
- [**Note**: see section 137A of the *Act*]
- 2.2.2 G The *Act* also provides that the *FCA* may use its general *rule*-making power to make product intervention rules prohibiting *authorised persons* from entering into specified agreements (section 137D of the *Act*). These *rules* may be made to advance:
- (1) the consumer protection objective; or
  - (2) the competition objective; or
  - (3) if an order made by the Treasury is in force, the market integrity objective.
- 2.2.3 G Section 137D(2) of the *Act* sets out that the *FCA* may prohibit *authorised persons* from:
- (1) entering into specified agreements with any *person* or specified person (specified person means a person who meets the description specified

by *FCA rules*);

- (2) entering into specified agreements with any *person* or specified person unless requirements specified in the *rules* have been satisfied;
- (3) doing anything that would or might result in the entering into specified agreements by *persons* or specified persons, or the holding by them of a beneficial or other kind of economic interest in specified agreements; and
- (4) doing anything within paragraph (3) unless requirements specified in the *rules* have been satisfied.

2.2.4 G Section 137D of the *Act* makes it clear that a range of options would be available to us in making *rules* prohibiting *authorised persons* from entering into specified agreements.

2.2.5 G The extent of the *rules* which are made will generally depend on the type of intervention deemed necessary to address the issues identified, having regard to whether the intervention would be a proportionate response to the perceived risk to *consumers*, competition failings or, if applicable, market integrity issues.

2.2.6 G *Rules* may range from:

- (1) requiring certain product features to be included, excluded or changed; or
- (2) requiring amendments to promotional materials; or
- (3) the imposition of restrictions on sales or marketing of the product; or
- (4) in more serious cases, a ban on sales or marketing of a product in relation to all or some types of *client*.

2.2.7 G Where the product is provided by a business outside of the *UK*, *rules* may be made targeting *regulated activities* by *authorised persons* in the *UK* that would lead to a specified agreement being formed.

[**Note:** see sections 137D(2)(c) and (d) of the *Act*]

## 2.3 Agreements made in breach of product intervention rules

2.3.1 G In relation to agreements entered into in breach of product intervention *rules*, section 137D(7) sets out that the *rules* may:

- (1) provide for a relevant agreement or obligation to be unenforceable against any *person* or specified person;
- (2) provide for the recovery of any money or other property paid or

transferred under a relevant agreement or obligation by any *person* or specified person; and

- (3) provide for the payment of compensation for any loss sustained by any *person* or specified person as a result of paying or transferring any money or other property under a relevant agreement or obligation.

2.3.2 G A relevant agreement or obligation would only be unenforceable if the sale of the product was made after the introduction of the *rules* and there was a contravention of those *rules*. *Clients* with products bought after the introduction of *rules* incorporating unenforceability provisions would generally need to seek redress through the usual channels of complaints to the *firm* and to the *Financial Ombudsman Service*, or legal action against the *firm*. However, they would not need to make their case beyond demonstrating that the agreement or arrangement was the subject of a product intervention *rule* (whether temporary or not) and that they entered into it after the relevant product intervention *rule* came into effect.

2.3.3 G Arrangements made before the introduction of the *rules* would not be affected by the unenforceability and compensation provisions. *Clients* holding contracts made before these *rules* were in place would still be able to seek redress through the usual channels of complaints to the *firm* and to the *Financial Ombudsman Service* or legal action against the relevant *firm*. These *clients* would need to establish their claim to redress in the usual way, for example by demonstrating that the advice they received was unsuitable, or that they bought the product after receiving a misleading *financial promotion*.

## 2.4 Temporary product intervention rules

2.4.1 G Normally the *FCA* must consult the public before making any *rules*. However, the *Act* allows a general exemption in section 138L where the *FCA* considers that the delay involved in complying with the requirement to consult would be prejudicial to the interests of *consumers*.

2.4.2 G There is also a specific exemption to the consultation requirement in relation to making *temporary product intervention rules* (section 138M of the *Act*). The *FCA* may make *temporary product intervention rules* without consultation if it considers that it is necessary or expedient not to comply with such a requirement to advance:

- (1) the consumer protection objective, or
- (2) the competition objective, or
- (3) if such an order made by the Treasury is in force, the market integrity objective.

2.4.3 G The *FCA*'s discretion to act under section 138M is therefore wider than

under section 138L.

- 2.4.4 G Decisions to make any *rules*, including *temporary product intervention rules*, will be taken by the *FCA* Board. In doing so, the *FCA* Board will have regard to all the available evidence, as well as the impact of the measure to be introduced by the *rule*.
- 2.4.5 G The *FCA* Board will consider whether the evidence is sufficient to support the proposed measure and whether the measure is a proportionate response to the issue identified.
- 2.4.6 G In publishing *temporary product intervention rules* the *FCA* will also publish the rationale for these *rules*.

## 2.5 Factors the *FCA* will consider when making temporary product intervention rules

- 2.5.1 G In general terms the *FCA* will consider a product intervention *rule* where we identify a risk of *consumer* detriment arising from a particular product, type of product, or practices associated with a particular product or type of product.
- 2.5.2. G In deciding whether the *rule* should be made as a *temporary product intervention rule*, the *FCA*'s main consideration will generally be whether prompt action is deemed necessary in seeking to reduce or prevent *consumer* detriment arising from that product, type of product or practices.

## 2.6 General considerations for product intervention rules

- 2.6.1 G Together with the considerations in *PROD 2.5*, when making temporary or permanent product intervention *rules*, the *FCA* will have regard to the regulatory principles set out in section 3B of the *Act*, (see *PROD 2.9*).
- 2.6.2 G The *FCA* will also take into account general considerations that include, but are not limited to, whether the proposed *rules* are:
  - (1) an appropriate and effective means of addressing actual or potential *consumer* detriment associated with a particular product or group of products;
  - (2) a proportionate and deliverable means of addressing actual or potential detriment;
  - (3) compatible with the *FCA*'s duty to promote effective competition in the interests of *consumers* (section 1B(4) of the *Act*);
  - (4) supported by sufficient and appropriate evidence;

- (5) transparent in their aim and operation; and
- (6) likely to be beneficial for *clients* when taken as a whole.

2.6.3 G The *FCA* will also consider the risk that the *rules* may have a negative impact on protected groups in the Equality Act 2010 and whether the *rules* can promote equality and good relations.

## 2.7 Contextual considerations for product intervention rules

2.7.1 G When the *FCA* is considering whether to make temporary or permanent product intervention *rules* in response to an identified issue with a product, the following factors will be taken into account:

- (1) The potential scale of detriment in the market. Issues involving products with a large or potentially large *client* base are more likely to require product intervention.
- (2) The potential scale of detriment to individual *clients*. Issues that may lead to high detriment for individual *clients* are more likely to require product intervention.
- (3) The social context. Issues that may lead to detriment for particular groups of *clients* (such as, in particular, vulnerable *client* groups) are more likely to require product intervention.
- (4) The market context. Market mechanisms such as information disclosure and competition do not always work to protect *consumers*.
- (5) Possible unintended consequences. Whether the use of product intervention *rules* or the timing of the intervention would in itself create undue risk of further *consumer* detriment, including harm to existing *clients* and in the market (although this will not necessarily comprise a full cost benefit analysis).

## 2.8 Competition considerations for temporary product intervention rules

2.8.1 G When making a temporary or permanent product intervention *rule*, the *FCA* will seek to promote effective competition in the interests of *consumers* where doing so is compatible with its consumer protection objective or integrity objective.

2.8.2 G In accordance with section 1E of the *Act* the *FCA* also has a competition objective and may make *rules*, including *temporary product intervention rules*, specifically to advance competition.

2.8.3 G Relevant competition-related considerations for the *FCA* in the context of

temporary or permanent product intervention *rules* are likely to include:

- (1) Whether there is reasonable scope for the *rules* under consideration to promote effective competition in the interests of *consumers*, for instance by addressing *consumer* behaviours that impair their ability to benefit from competition, by reducing information asymmetries or by correcting misaligned incentives.
- (2) Whether the *rule* under consideration may have a negative impact on competition factors such as product innovation and barriers to entry for new market participants.
- (3) Whether any negative impact on competition factors is proportionate, having regard to the aims of the *rule* under consideration.
- (4) Whether alternative solutions may deliver the same intended outcome while having a more positive impact on competition.
- (5) The overall effect of a proposed *rule* upon the operation of effective competition in the market for financial services, having regard to the interests of *consumers*.

- 2.8.4 G Where promoting competition, further to the duty in section 1B(4), would be in conflict with the consumer protection or (if applicable) market integrity aims of a proposed *temporary product intervention rule*, the consumer protection or market integrity aims will take precedence over competition considerations.

## 2.9 Regulatory principles

- 2.9.1 G The *FCA* will have regard to the regulatory principles set out in section 3B of the *Act* when making *temporary product intervention rules*.

- 2.9.2 G As part of the *FCA*'s consideration of issues including the desirability of facilitating innovation, we will consider the potential deterrent effect on entry and innovation when making *temporary product intervention rules* against the potential for reducing anticipated *consumer* detriment.

## 2.10 Process for making temporary product intervention rules

- 2.10.1 G Once initial proposals have been discussed, a paper will be prepared at working group level for a committee (the Committee) with appropriate authority to propose *temporary product intervention rules* to the *FCA* Board.

- 2.10.2 G The Committee will either endorse the proposals and recommend that they are taken to the Board, or suggest rethinking the proposals and coming back at a later date. A decision may be taken to use a different regulatory tool, or

not to proceed.

- 2.10.3 G If the Committee decides that the proposals should go to the Board, the paper will be taken to the next available scheduled Board meeting, unless the matter is of great importance or there is an emergency, in which case the Board may convene specifically to consider the issue.
- 2.10.4 G If the Board makes a decision to act on the policy proposals the *FCA* will publish the *temporary product intervention rules* on its website and take the necessary follow-up actions.

## 2.11 Consulting the panels

- 2.11.1 G The *FCA* will generally seek the views of the Financial Services Practitioner Panel, the Smaller Businesses Practitioner Panel and the Financial Services Consumer Panel during the process for making *temporary product intervention rules* if there is sufficient time to do so.

## 2.12 Consulting the PRA

- 2.12.1 G The *FCA* will discuss any proposed product intervention *rules* (whether temporary or not) with the *PRA*.

## 2.13 Communication, publication and post-implementation review of temporary product intervention rules

- 2.13.1 G Before making a *temporary product intervention rule*, the Committee will consider how affected *firms* and *clients* are to be informed of the *rule* in good time.
- 2.13.2 G The *FCA* will publish a statement on its website explaining why it is introducing the *rule*. The *FCA* may choose to invite feedback, but this will not amount to a consultation exercise.
- 2.13.3 G The *FCA* may choose to review a *temporary product intervention rule* during the term for which the *rule* is in force. Such a review will generally depend on the perceived risk the *rule* seeks to mitigate. These reviews may be informed by market monitoring and feedback from stakeholders, including product *manufacturers*, *distributors* and *clients*.
- 2.13.4 G Where the *FCA* perceives potential uncertainty about how the *rule* operates, it may consider publishing *guidance*.
- 2.13.5 G Reviews are likely to consider whether a *rule* is functioning as intended, including whether:

- (1) there have been any breaches of the *rule*; or
- (2) there are any unintended consequences, such as an impact on products that were not intended to be caught by the *rule*; or
- (3) there is evidence suggesting *firms* are working around the *rule* rather than complying with it, for instance where new products enter the market or new features are added to existing products that expose *clients* to the same or similar potential detriment; or,
- (4) new evidence demonstrates that the *rule* is not necessary or detriment is unlikely.

2.13.6 G As a result of these reviews, where necessary, the *FCA* may:

- (1) revoke a *temporary product intervention rule*; or
- (2) where a *rule* specifies certain criteria under which the sale of a product may continue, change these criteria.

2.13.7 G Subsequent changes to a *temporary product intervention rule* will be communicated by issuing a new statement containing the revised *rule* and the rationale for the changes. Such changes will not extend the lifespan of the *temporary product intervention rule*.

2.13.8 G However, the *FCA* may consult on a new *rule* to replace the *temporary product intervention rule* from the date on which the *temporary product intervention rule* ceases to have effect. This exercise would be subject to the *FCA*'s standard *rule-making* exercise, including market failure analysis, cost benefit analysis and consultation to which all stakeholders, including *manufacturers, distributors* and *clients* would be invited to reply.

## 2.14 Revocation or replacement of rules

2.14.1 G When making *temporary product intervention rules* the *FCA* will state the duration of the *rule* and the date from which it will be effective. *Temporary product intervention rules* will have a maximum duration of 12 *months* from when the *rule* is made, but the *FCA* may decide on a shorter duration for a *rule*.

2.14.2 G The *FCA* may review or revoke *temporary product intervention rules* at any time before the end of the period for which they apply.

2.14.3 G *Rules* may be revoked or changed for a number of reasons, including but not limited to:

- (1) new *rules* are introduced on a permanent basis following a consultation exercise; or



- (2) new *rules* being introduced at *EU* level; or
- (3) industry initiatives are developed that specify sufficient minimum standards to address the sources of *consumer* detriment; or
- (4) further evidence is submitted that demonstrates that *consumer* detriment will not occur; or
- (5) demand for, or supply of, the relevant product disappears and is deemed unlikely to return; or,
- (6) the *FCA* identifies unforeseen negative effects of the *rule* which outweigh any positive impact upon consumer protection.

2.14.4 G Where *temporary product intervention rules* have been made, the *FCA* may not make further *temporary product intervention rules* containing the same, or substantially the same, provisions within a prohibited period. This period is 12 *months* beginning on the day on which the limited duration of the initial *rules* ends (whether or not the *rules* were revoked early). The prohibited period does not apply to *rules* that are not *temporary product intervention rules*, (i.e. *rules* which had been made subject to consultation, whether or not of set duration).

### 3 Product governance: MiFiD

#### 3.1 General

Interpretation: financial instruments and structured products

3.1.1 R For the purposes of *PROD 3*, references to *financial instrument* include *structured deposits*.

Proportionate application of rules

3.1.2 R (1) A *firm* must, when *manufacturing financial instruments* or deciding on the range of *financial instruments* and *investment services* it intends to *distribute* to *clients*, comply, in a way that is appropriate and proportionate, with the requirements set out in this chapter.

(2) In complying with those requirements, a *firm* must take into account:

- (a) the nature of the *financial instrument* or *investment service*;  
and
- (b) the target market for the *financial instrument*.

[**Note:** articles 9(1) and 10(1) of the *MiFID Delegated Directive*]

3.1.3 G A proportionate application of the requirements in this chapter may mean that the *rules* could be relatively simple for simple *financial instruments*

distributed on an *execution-only transaction* basis where such *financial instruments* would be compatible with the needs and characteristics of the mass retail market.

### 3.2 Manufacture of products

#### General

3.2.1 R A *manufacturer* must:

- (1) ensure that the *financial instruments* it *manufactures* are designed to meet the needs of an identified target market of *end clients*;
- (2) ensure that the strategy for *distribution* of the *financial instruments* is compatible with the identified target market; and
- (3) take reasonable steps to ensure that the *financial instrument* is *distributed* to the identified target market.

[Note: article 24(2) of *MiFID*]

3.2.2 G Consideration of target market factors should permeate all aspects of product development and *distribution*, as well as ensuring the selection of appropriate *distribution* channels and the promotion of the *financial instruments* are accompanied by sufficient and correct information.

#### Product governance arrangements

3.2.3 R A *manufacturer* must maintain, operate and review a process for the approval of:

- (1) each *financial instrument*, and
  - (2) significant adaptations of existing *financial instruments*,
- in each case before they are marketed or *distributed* to *clients*.

[Note: article 16(3) of *MiFID*]

3.2.4 R For each *financial instrument* the product approval process must:

- (1) specify an identified target market of *end clients*;
- (2) ensure that all relevant risks to the identified target market are assessed; and
- (3) ensure that the intended *distribution* strategy is consistent with the identified target market.

[Note: article 16(3) of *MiFID*]

- 3.2.5 G When designing *financial instruments*, a *firm* should have in place systems and controls to manage adequately the risks posed by *financial instrument* design.

Manufacture by more than one firm

- 3.2.6 R Where *firms* collaborate to *manufacture* a *financial instrument*, only one target market needs to be identified.

[Note: article 9(9) of the *MiFID Delegated Directive*]

- 3.2.7 R Where *firms* collaborate, including with entities which are not authorised and supervised in accordance with *MiFID* or *third country investment firms*, to create, develop, issue and/or design a *financial instrument*, they must outline their mutual responsibilities in a written agreement.

[Note: article 9(8) of the *MiFID Delegated Directive*]

Target market

- 3.2.8 R *Manufacturers* must identify the potential target market for each *financial instrument* at a sufficiently granular level and must:

- (1) specify the type or types of *client* for whose needs, characteristics and objectives the *financial instrument* is compatible; and
- (2) identify any group or groups of *client* for whose needs, characteristics and objectives the *financial instrument* is not compatible.

[Note: article 9(9) of the *MiFID Delegated Directive*]

- 3.2.9 G The level of granularity of the target market and the criteria used to define the target market and determine the appropriate *distribution* strategy should be relevant for the *financial instrument* and should make it possible to assess which *clients* fall within the target market. For simpler, more common *financial instruments*, the target market could be identified with less detail while for more complicated *financial instruments* such as bail-inable instruments or less common *financial instruments*, the target market should be identified with more detail.

[Note: recital 19 of the *MiFID Delegated Directive*]

- 3.2.10 R *Manufacturers* must determine for each *financial instrument* they *manufacture*, whether it meets the identified needs, characteristics and objectives of the target market, and in doing so must include an examination of the following elements:

- (1) whether the *financial instrument's* risk/reward profile is consistent with the target market; and

- (2) whether the design of the *financial instrument* is driven by features that benefit the *client* and not by a business model which relies on poor *client* outcomes to be profitable.

[**Note:** article 9(11) of the *MiFID Delegated Directive*]

3.2.11 R *Manufacturers of financial instruments* that are *distributed* through other *firms* must determine the needs and characteristics of the *clients* for whom the product is compatible based on:

- (1) their theoretical knowledge of, and past experience with, the *financial instrument* or similar *financial instruments*;
- (2) the financial markets, and
- (3) the needs, characteristics and objectives of potential *end clients*.

[**Note:** article 9(9) of the *MiFID Delegated Directive*]

3.2.12 G A *manufacturer* should ensure that the complexity of the investment proposition is a reasonable match to the level of financial sophistication and understanding of the *financial instrument*'s target market so as to give prospective *clients* a fair opportunity to evaluate the product and understand the likelihood of a range of returns (including the possibility of receiving no return on their capital or making a loss).

Product testing

3.2.13 R *Manufacturers* must undertake a scenario analysis of their *financial instruments* to assess:

- (1) the risks of poor outcomes for *end clients* posed by the *financial instrument*; and
- (2) in which circumstances those poor outcomes may occur.

[**Note:** article 9(10) *MiFID Delegated Directive*]

3.2.14 R In conducting the scenario analysis *manufacturers* must assess their *financial instruments* under negative conditions covering what would happen if, for example:

- (1) the market environment deteriorated; or
- (2) the *manufacturer* or a third party involved in *manufacturing* and/or the functioning of the *financial instrument* experiences financial difficulties or other counterparty risk materialises; or
- (3) the *financial instrument* fails to become commercially viable; or
- (4) demand for the *financial instrument* is much higher than anticipated, putting a strain on the *firm*'s resources and/or on the market of the

underlying *financial instrument*.

[**Note:** article 9(10) *MiFID Delegated Directive*]

- 3.2.15 G When conducting the scenario analysis *manufacturers* should take into account the following:
- (1) Stress tests should be forward- as well as backward-looking, given the limited value of past performance in replicating potential future returns.
  - (2) Stress tests should analyse the resilience of the *financial instrument* over its proposed term, in particular so that the product's risk profile may be properly assessed.
  - (3) The output from the stress-testing and modelling exercised should be considered by the *firm* as part of the new product approval process.
  - (4) For quantitative modelling *manufacturers* should undertake simulations to understand expected profitability from the *end client's* point of view and consider what a reasonable comparison is for the next best use of the *end client's* money.
  - (5) Any assumptions made during the scenario analysis should be reasonable, based on publicly available data and should not result in a misleadingly favourable impression of potential returns.
  - (6) *Manufacturers* should establish thresholds on the probability of stressed outcomes that are likely to be acceptable for the intended target market.

- 3.2.16 R *Manufacturers* must consider the charging structure proposed for each *financial instrument*, including examination of the following:
- (1) whether the *financial instrument's* costs and charges are compatible with the needs, objectives and characteristics of the target market;
  - (2) whether the charges 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
  - (3) whether 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.

[**Note:** article 9(12) of the *MiFID Delegated Directive*]

- 3.2.17 R *Manufacturers* must consider whether the *financial instrument* may represent a threat to the orderly functioning, or to the stability, of financial markets before deciding to proceed with the launch of the *financial*

*instrument.*

[**Note:** article 9(4) of the *MiFID Delegated Directive*]

Distribution strategy and information disclosure to distributors

3.2.18 G A *manufacturer* should define its *distribution* strategy so that this strategy favours the sale of each *financial instrument* to the target market that has been identified.

3.2.19 R A *manufacturer* must make available to any *distributor* of that *financial instrument*:

- (1) all appropriate information on the *financial instrument*;
- (2) all appropriate information on the product approval process;
- (3) the identified target market of the *financial instrument*, including information about the target market assessment undertaken; and
- (4) information about the appropriate channels for *distribution* of the *financial instrument*,

and must ensure that the information is of an adequate standard to enable *distributors* to understand and recommend or sell the *financial instrument* properly.

[**Note:** article 16(3) of *MiFID II* and 9(13) of the *MiFID Delegated Directive*]

3.2.20 G When providing information to *distributors*, a *manufacturer* should make it clear if that information is not intended for *end client* use.

3.2.21 G *Manufacturers* may consider, for example, with regard to each *distribution* channel or type of *distributor* what information *distributors* of that type already have, their likely level of knowledge and understanding, their information needs and what form or medium would best meet those needs (which could include discussions, written material or training as appropriate).

Review of financial instruments

- 3.2.22 R
- (1) A *manufacturer* must regularly review the *financial instruments* it *manufactures* taking into account any event that could materially affect the potential risk to the identified target market.
  - (2) In doing so, a *manufacturer* must assess for each *financial instrument* at least the following:
    - (a) whether the *financial instrument* remains consistent with the needs, characteristics and objectives of the identified target market;

- (b) whether the intended *distribution* strategy remains appropriate;
- (c) whether the *financial instrument* is being *distributed* to the target market; and
- (d) whether the *financial instrument* is reaching *clients* for whose needs, characteristics and objectives the *financial instrument* is not compatible.

[**Note:** article 16(3) of *MiFID II* and article 9(14) of the *MiFID Delegated Directive*]

- 3.2.23 G In carrying out the reviews in *PROD 3.2.22R* *manufacturers* should collect and analyse appropriate management information to detect patterns in *distribution* as compared with the planned target market in order to assess the performance of the *distribution* channels through which a *financial instrument* is being *distributed*.
- 3.2.24 G (1) When reviewing the *financial instruments* it *manufactures*, a *firm* should communicate to the *end client* contractual “breakpoints” such as the end of a long tie-in period that may have a material impact on the *end client* that the *end client* cannot reasonably be expected to recall or know about already.
- (2) If the *manufacturer* does not know the identity of the *end client*, it should communicate any contractual breakpoints to the *distributor*.
- 3.2.25 R *Manufacturers* must:
- (1) review *financial instruments* prior to any further issue or re-launch if they are aware of any event that could materially affect the potential risk to *clients*; and
- (2) identify crucial events that would affect the potential risk or return expectations of the *financial instrument*.
- 3.2.26 G Crucial events that would affect the potential risk or return expectations of the *financial instrument* include:
- (1) the crossing of a threshold that will affect the return profile of the *financial instrument*; or
- (2) the solvency of certain issuers whose securities and guarantees may impact the performance of the *financial instrument*.
- 3.2.27 R When a crucial event affecting the potential risk or return expectation of the *financial instrument* occurs, a *manufacturer* must take appropriate action, which may consist of:
- (1) the provision of any relevant information on the event and its consequences on the *financial instrument* to the *clients* or

*distributors* of the *financial instrument* if the *manufacturer* does not offer or sell the *financial instrument* directly to the *clients*;

- (2) changing the product approval process;
- (3) stopping further issuance of the *financial instrument*;
- (4) changing the *financial instrument* to avoid unfair contract terms;
- (5) considering whether the sales channels through which the *financial instrument* is sold are appropriate where the *manufacturer* becomes aware that the *financial instrument* is not being sold as envisaged;
- (6) contacting the *distributor* to discuss a modification of the *distribution* process;
- (7) terminating the relationship with the *distributor*; or
- (8) informing the relevant *competent authority*.

3.2.28 R *Manufacturers* must review *financial instruments* at regular intervals to assess whether they function as intended.

3.2.29 R *Manufacturers* must determine how regularly to review their *financial instruments* based on relevant factors including factors linked to the complexity or the innovative nature of the investment strategies pursued.

[**Note:** article 9(15) of the *MiFID Delegated Directive*]

#### Conflicts of Interest

3.2.30 R *Manufacturers* must establish, implement and maintain procedures and measures to ensure the *manufacture* of *financial instruments* complies with the requirements on proper management of conflicts of interest (SYSC 10.1.7R), including *remuneration*.

3.2.31 R *Manufacturers* must ensure that the design of each *financial instrument*, including its features, does not:

- (1) adversely affect *end clients*; or
- (2) lead to problems with market integrity by enabling the *firm* to mitigate and/or dispose of its own risk or exposure to the underlying assets of the product where the *firm* already holds the underlying assets on own account.

[**Note:** article 9(2) of the *MiFID Delegated Directive*]

3.2.32 R Each time a *financial instrument* is *manufactured* *manufacturers* must analyse potential conflicts of interests.

3.2.33 R In analysing potential conflicts of interest *manufacturers* must assess



whether the *financial instrument* creates a situation where *end clients* may be adversely affected if they take:

- (1) an exposure opposite to the one previously held by the *firm* itself; or
- (2) an exposure opposite to the one that the *firm* wants to hold after the sale of the product.

[**Note:** article 9(3) of the *MiFID Delegated Directive*]

#### Oversight and training requirements

- 3.2.34 R *Manufacturers* must ensure that their *management bodies* have effective control over their product governance process.
- 3.2.35 R The development and periodic review of product governance arrangements shall be overseen by the *person* allocated the *compliance oversight function* of a *firm*.

[**Note:** article 9(6) and article 9(7) of the *MiFID Delegated Directive*]

- 3.2.36 R All relevant staff involved in the *manufacturing* of *financial instruments* must possess the necessary expertise to understand the characteristics and risks of the *financial instruments* they intend to *manufacture*.

[**Note:** article 9(5) of the *MiFID Delegated Directive*]

- 3.2.37 G *Firms* should have regard to SYSC 5.1 when considering whether their relevant staff have the necessary expertise.

#### Compliance reports

- 3.2.38 R Compliance reports to the *management body* must include information about the *financial instruments* that the *firm* has *manufactured*, including information on the *distribution* strategy.
- 3.2.39 R *Manufacturers* must make the compliance reports available to their *competent authority* on request.

[**Note:** article 9(6) *MiFID Delegated Directive*]

### 3.3 Distribution of products and investment services

#### General

- 3.3.1 R A *distributor* must:
- (1) understand the *financial instruments* it *distributes* to *clients*;
  - (2) assess the compatibility of the *financial instruments* with the needs of the *clients* to whom it *distributes investment services*, taking into

account the *manufacturer's* identified target market of *end clients*;  
and

- (3) ensure that *financial instruments* are *distributed* only when this is in the best interests of the *client* (see COBS 2.1.1R(1)).

[Note: article 24(2) of MiFID]

- 3.3.2 G A *distributor* should consider what impact the selection of a given *manufacturer* could have on the *end client* in terms of charges or the financial strength of the *manufacturer*, or possibly, where information is available to the *distributor*, how efficiently and reliably the *manufacturer* will deal with the *distributor* or *end client* at the point of sale (or subsequently, such as when queries/complaints arise, claims are made, or a *financial instrument* reaches maturity).

Obtaining information from manufacturers

- 3.3.3 R *Distributors* must obtain from *MiFID manufacturers* information to gain the necessary understanding and knowledge of the *financial instruments* they intend to *distribute* in order to ensure that the *financial instruments* will be *distributed* in accordance with the needs, characteristics and objectives of the target market.

[Note: article 16(3) MiFID and article 10(2) MiFID Delegated Directive]

- 3.3.4 G In ensuring that they have obtained sufficient information about the *financial instruments* they *distribute* and in ensuring they understand the *financial instruments* or *investment services distributed*, *distributors*:
- (1) should consider whether they understand the materials provided by the *manufacturer* or *distributor* earlier in the sales chain;
  - (2) should ask the *manufacturer* to supply additional information or training where this seems necessary to understand the *financial instrument* or *investment service* adequately;
  - (3) should not *distribute* the *financial instrument* or *investment service* if it does not understand it sufficiently; and
  - (4) when providing information to another *distributor* in a distribution chain, should consider how the further *distributor* will use the information, such as whether it will be given to *end clients*. *Firms* should consider what information the further *distributor* requires and the likely level of knowledge and understanding of the further *distributor* and what medium may suit it best for the transmission of information.

Distributing financial instruments manufactured by non-MiFID firms, including third country firms

- 3.3.5 R (1) *Distributors* must comply with *PROD 3.3* when *distributing financial instruments manufactured* by any firm to which *MiFID manufacturer* product governance requirements (*PROD 3.2* or equivalent requirements of another *EEA State*) do not apply.
- (2) As part of this, *distributors* must put in place effective arrangements to ensure that they obtain sufficient, adequate and reliable information from the *manufacturer* about the *financial instruments* to ensure that they will be *distributed* in accordance with the characteristics, objectives and needs of the target market.
- (3) This *rule* applies to *financial instruments* sold on either the primary or secondary market.
- 3.3.6 R The obligation to obtain adequate and reliable information applies proportionately depending on,
- (1) the degree to which publicly available information is obtainable and
- (2) the complexity of the *financial instrument*
- [**Note:** articles 10(1) and 10(2) of the *MiFID Delegated Directive*]
- 3.3.7 R Where information relevant to the obligation in *PROD 3.3.5R* is not publicly available, *distributors* must take all reasonable steps to obtain such relevant information from the *manufacturer* or its agent.
- 3.3.8 G Acceptable publicly available information is information which is clear, reliable and produced to meet regulatory requirements, such as disclosure requirements under the *Prospectus Directive* or the *Transparency Directive*.
- [**Note:** article 10(2) of the *MiFID Delegated Directive*]
- Target market and distribution strategy
- 3.3.9 R *Distributors* must determine the target market for the respective *financial instrument*, even if the target market was not defined by the *manufacturer*.
- [**Note:** article 10(1) of the *MiFID Delegated Directive*]
- 3.3.10 R *Distributors* must identify the target market and their *distribution* strategy using:
- (1) the information obtained from *manufacturers*, and
- (2) information they have on their own *clients*.
- 3.3.11 G In identifying the target market and creating a *distribution* strategy, *distributors* should consider:
- (1) the nature of the *financial instruments* to be offered or recommended

and how they fit with *end clients*' needs and risk appetite;

- (2) the impact of charges on *end clients*;
- (3) the financial strength of the *manufacturer*; and
- (4) where information is available on the *manufacturer's* processes, how efficiently and reliably the *manufacturer* will deal with the *end client* at the point of sale or subsequently, such as when complaints arise, claims are made or the *financial instrument* reaches maturity.

- 3.3.12 G The target market identified by *distributors* for each *financial instrument* should be identified at a sufficiently granular level.
- 3.3.13 G Where a *distributor* is part of a distribution chain, the information referred to in *PROD 3.3.10R(2)* should include information on the intended *end client*.
- 3.3.14 R Where a *firm* acts both as a *manufacturer* and a *distributor*, only one target market assessment is required.

[**Note:** article 10(2) of the *MiFID Delegated Directive*]

- 3.3.15 R (1) *Distributors* must have in place adequate product governance arrangements to ensure that:
  - (a) the *financial instruments* and *investment services* they intend to *distribute* are compatible with the needs, characteristics and objectives of the identified target market; and
  - (b) the intended *distribution* strategy is consistent with the identified target market.
- (2) *Distributors* must appropriately identify and assess the circumstances and needs of the *clients* they intend to focus on to ensure that their *clients'* interests are not compromised as a result of commercial or funding pressures.
- (3) *Distributors* must identify any groups of *end clients* for whose needs, characteristics and objectives the *financial instrument* or *investment service* is not compatible.

[**Note:** article 10(2) of the *MiFID Delegated Directive*]

- 3.3.16 G In the design of *investment services*, to help *clients* make an informed investment decision, *firms* should consider the support *clients* need before they reach the product selection part of the process.
- 3.3.17 R *Distributors* must have in place procedures and measures to ensure that when deciding the range of *financial instruments* and *investment services* to be *distributed*, and the target market, all applicable *rules* are complied with, including but not limited to:

- (1) disclosure [*COBS* 4 and *COBS* 14.3];
- (2) suitability [*COBS* 9];
- (3) appropriateness [*COBS* 10];
- (4) inducements [*COBS* 2.3]; and
- (5) conflicts of interest [*SYSC* 10.1].

3.3.18 G *Distributors* should take particular care to ensure compliance with *PROD* 3.3.17R when they intend to *distribute* new *financial instruments* or there are variations to the *investment services* they provide.

[**Note:** article 10(3) of the *MiFID Delegated Directive*]

#### Oversight and training requirements

3.3.19 R The development and periodic review of product governance arrangements must be overseen by the *person* allocated the *compliance oversight function* of a *firm*.

[**Note:** article 10(6) of the *MiFID Delegated Directive*]

3.3.20 R The *management body* of a *distributor* must have effective control over the *firm's* product governance process to determine:

- (1) the range of *financial instruments* the *firm* offers or recommends, and
- (2) the *investment services* provided to the respective target markets.

[**Note:** article 10(8) of the *MiFID Delegated Directive*]

3.3.21 R All relevant staff must possess the necessary expertise to understand:

- (1) the characteristics and risks of the *financial instruments* that the *firm* intends to *distribute*;
- (2) the *investment services* provided by the *firm*; and
- (3) the needs, characteristics and objectives of the identified target market.

[**Note:** article 10(7) of the *MiFID Delegated Directive*]

3.3.22 G *Firms* should have regard to *SYSC* 5.1 and in particular *SYSC* 5.1.5ABG when considering whether their relevant staff have the necessary expertise.

#### Compliance reports

3.3.23 R Compliance reports to the *management body* must include information about

the *financial instruments distributed* by the firm and the *investment services* provided.

- 3.3.24 R A *distributor* shall make the compliance reports available to *competent authorities* on request.

[**Note:** article 10(8) of the *MiFID Delegated Directive*]

Post-sale review

- 3.3.25 R *Distributors* must periodically review their product governance arrangements under *PROD 3.3.15R* and must take appropriate actions where necessary to ensure they remain robust and fit for their purpose.

[**Note:** article 16(3) of *MiFID* and article 10(4) of the *MiFID Delegated Directive*]

- 3.3.26 R *Distributors* must regularly review the *financial instruments* they *distribute* and the *investment services* they provide, taking into account any event that could materially affect the potential risk to the identified target market.

- 3.3.27 R In carrying out the review in *PROD 3.3.26R*, *distributors* must assess at least:

- (1) whether the *financial instrument* or *investment service* remains consistent with the needs, characteristics and objectives of the identified target market; and
- (2) whether the intended *distribution* strategy remains appropriate.

- 3.3.28 R If a *distributor* becomes aware that it has wrongly identified the target market for a specific *financial instrument* or *investment service*, or the *financial instrument* or *investment service* no longer meets the circumstances of the identified target market, it must take appropriate steps, including at least:

- (1) reconsidering the target market; and/or
- (2) updating its product governance arrangements.

- 3.3.29 G A *distributor* may need to take action under *PROD 3.3.28R* in circumstances where the *financial instrument* becomes very illiquid or very volatile due to market changes.

[**Note:** article 16(3) of *MiFID* and article 10(5) of the *MiFID Delegated Directive*]

Information sharing

- 3.2.30 R A *distributor* must provide to the *manufacturer* of each *financial instrument* it *distributes*:

- (1) information on sales; and
  - (2) where appropriate, information on the reviews carried out under *PROD 3.3.25R-3.3.27R*.
- 3.2.31 G (1) Information on sales should include information on any sales made outside the target market.
- (2) In complying with *PROD 3.3.30R* it is not necessary to report every sale to the *manufacturer*. *Distributors* should provide the data necessary for the *manufacturer* to review the *financial instrument* and check that it remains consistent with the needs, characteristics and objectives of the target market defined by the *manufacturer*. Relevant information could include:
- (a) summary information of the types of *clients*;
  - (b) a summary of complaints received; and
  - (c) responses from *clients* to questions suggested by the *manufacturer* for the purposes of obtaining feedback from a *client* sample.
- (3) In determining when providing information on the reviews carried out under *PROD 3.3.25R-3.3.27R* is appropriate, a *distributor* should have regard to the requirements on the *manufacturer* in *PROD 3.2*. Information on the reviews should be shared if the *manufacturer* requests it.

[**Note:** article 10(9) of and recital 20 to the *MiFID Delegated Directive*]

#### Responsibilities in chains of distributors

- 3.3.32 R (1) A *firm* which *distributes financial instruments* or *investment services* to *end clients* is responsible for ensuring that the obligations in this chapter are met in respect of any *financial instrument* or *investment service* it *distributes* to an *end client*.
- (2) A *firm* which *distributes financial instruments* to *clients* which are not *end clients* must, in addition to complying with the rules in this chapter, consider if they are also undertaking a *manufacturing* role and, if they are, also apply *PROD 3.2*.
- 3.2.33 R A *distributor* which *distributes financial instruments* to other *distributors* must:
- (1) ensure that relevant product information is passed from the *manufacturer* to the final *distributor* in the chain, and
  - (2) if the *manufacturer* requires information on product sales in order to comply with its obligations under *PROD 3.2*, enable them to obtain

it.

[**Note:** article 10(10) of the *MiFID Delegated Directive*]



## Annex O

## Amendments to the Perimeter Guidance manual (PERG)

In this Annex, underlining indicates new text and striking through indicates deleted text.

## 1 Introduction to the Perimeter Guidance manual

...

### 1.5 What other guidance about the perimeter is available from the FCA?

1.5.1 G General *guidance* on the perimeter is also contained in various *FCA* documents (mainly fact sheets and frequently asked questions) that are available on the FCA website at [www.fca.org.uk](http://www.fca.org.uk). These documents, and the URL on which they may be accessed, include:

...

- (11) joint guidance by the *FSA* and the Office of Fair Trading titled “Payment protection products” (January 2013) which includes discussion whether debt freezes and debt waivers are *contracts of insurance* (~~[www.fca.org.uk/your-fca/documents/finalised-guidance/fsa-fg132](http://www.fca.org.uk/your-fca/documents/finalised-guidance/fsa-fg132)~~ <https://www.fca.org.uk/publication/finalised-guidance/fsa-fg13-02.pdf>); ~~and~~
- (12) The *FSA*’s views on whether members of the NHBC who provide insurance to buyers of properties in accordance with the Buildmark scheme carry out *insurance mediation*, contained in a letter to NHBC’s solicitors and put onto the *FSA*’s Freedom of Information Act register in December 2012 (~~[www.fca.org.uk/your-fca/documents/fsa-foi2707-request-information](http://www.fca.org.uk/your-fca/documents/fsa-foi2707-request-information)~~ <https://www.fca.org.uk/publication/foi/fsa-foi2707-info.pdf>); ~~and~~
- (13) *guidance on the regulated activity of advising on investments (except P2P agreements) and on the corresponding MiFID activity of giving investment advice in the FCA’s Finalised Guidance document FG15/1 (Retail investment advice: Clarifying the boundaries and exploring the barriers to market development) available at <https://www.fca.org.uk/publication/finalise-guidance/fg15-01.pdf>.*

...

## 2 Authorisation and regulated activities

...

### 2.5 Investments and activities: general

...

2.5.6 G ...

Wider definition of certain specified investments when carrying on some kinds of EU business

2.5.7 G Some *specified investments* are defined so that certain products only come within that definition when a *person* is providing services under certain *EU* legislation in relation to that product.

2.5.8 G When *PERG 2.5.7G* applies, the product is only treated as falling within the definition of the *specified investment* concerned if (in relation to that product):

(1) one of the following *persons*:

(a) a *MiFID investment firm*; or

(b) a *third country investment firm*; or

(c) a *CRD credit institution*; or

(d) a *credit institution* that would qualify to be a *CRD credit institution* if its registered or head office were in the *EEA*;

provides or performs *investment services and/or activities* on a professional basis; or

(2) a *UCITS investment firm* is providing certain *investment services and/or activities* under article 6.3 of the *UCITS Directive* (provision of services in addition to *UCITS* management); or

(3) a *market operator* (or someone who would be a *market operator* if it was based in the *EEA*) is providing the *investment services and/or activities* of operating a *multilateral trading facility* or *organised trading facility* (these activities are described in Q24 and Q24A in *PERG 13.3*); or

(4) an *AIFM investment firm* is providing services under article 6.4 of the *AIFMD* (provision of services in addition to *AIF* management).

2.5.9 G *PERG 2.5.7G* only applies to the following *specified investments*:

(1) *emission allowances* (see *PERG 2.6.19G* for more details);

(2) *options* (see *PERG 2.6.20G* for more details);

(3) *futures* (see *PERG 2.6.22AG* for more details); and

(4) credit derivatives treated as *contracts for differences* (see *PERG 2.6.23G* for more details).

- 2.5.10 G (1) When deciding whether a *person* is a *MiFID investment firm* or a *third country investment firm* for the purposes of *PERG 2.5.8G(1)*, it is necessary to take into account the services that that *person* is providing in relation to the product concerned.
- (2) For example, say that a *UK person* does business in an option product to which *PERG 2.5.7G* applies. When deciding whether that product is a regulated *option*, it is not necessary for that *person* already to be:
- (a) a *MiFID investment firm*; or
- (b) *authorised* under the *Act*;
- because of its other activities.
- (3) Therefore, when deciding whether the *UK person* in (2) is a *MiFID investment firm* and whether it needs to be *authorised* under the *Act*, it is necessary to take into account all the business it does, including business in that option product.

...

## 2.6 Specified investments: a broad outline

...

### Greenhouse gas emissions allowances

- 2.6.19D G (1) There are two *specified investments* relating to the scheme for greenhouse gas *emissions allowance* trading within the *EU*:
- (1) the first kind comprises *emissions allowances* that are
- (a) auctioned as *financial instruments* or *two-day emissions spots* (together, *emissions auction products*); and
- (2) ~~The~~ the second kind is an *emissions allowance* itself, subject
- (b) to (3 2).
- (32) If (1)(a) does not apply, an *emission allowance* is only a *specified investment* if a *MiFID investment firm* or one of the other *persons* listed in *PERG 2.6.20G(2)* provides or performs one of the activities or services listed in *PERG 2.6.20G(2)* in relation to it *PERG 2.5.7G* (Wider definition of certain specified investments when carrying on some kinds of EU business) applies.
- (43) An *emissions allowance* can also be the underlying for an *option*, *future* or *contract for differences*.

2.6.19E G ...

2.6.19F G ~~For the purposes of the RAO, this *specified investment* is not~~ See PERG 2.7.6DG for more about:

- (1) how the RAO deals with the overlap between *emission allowances* and *emissions auction products*; and
- (2) whether these products are a *security*, a *contractually-based investment* or a *relevant investment*.

...

#### Options

2.6.20 G The *specified investment* category of *options* comprises:

...

- (2) options to acquire or dispose of other property and falling within paragraphs 5, 6, 7 or 10 of Annex 1 to *MiFID* (see article 83(2) of the *Regulated Activities Order* and *PERG 13, Q32 Q33A* to Q34 for *guidance* about these instruments), but only where they are options in relation to which: *PERG 2.5.7G* (Wider definition of certain *specified investments* when carrying on some kinds of EU business) applies; and
  - (a) ~~a *MiFID investment firm* or a *third country investment firm* provides or performs *investment services and activities* on a professional basis; or~~
  - (b) ~~a *UCITS investment firm* is providing certain *investment services and activities* under article 6.3 of the *UCITS Directive* (provision of services in addition to *UCITS* management); or~~
  - (c) ~~a *market operator* (or someone who would be a *market operator* if it was based in the *EEA*) is providing the *investment services and activities* of operating a multilateral or organised trading facility (these activities are described in Q24 and Q24A in *PERG 13.3*); or~~
  - (d) ~~an *AIFMD investment firm* is providing services under articles 6.4 and 6.5 of the *AIFMD* (provision of services in addition to *AIF* management); and~~

...

#### Futures

...

2.6.22A G As with *options*, there is an additional category of instruments which are *futures* only in limited circumstances. These are contracts as described in

PERG 2.6.21G:

- (1) ...
- (2) that fall within paragraphs 5, 6, 7 or 10 of Annex 1 to *MiFID* (see *PERG 13, Q32 Q33A* to Q34 for *guidance* about these derivatives); and
- (3) in relation to which ~~a *MiFID investment firm* or one of the other persons listed in *PERG 2.6.20G(2)* provides or performs any of the activities or services listed in *PERG 2.6.20G(2)*~~ *PERG 2.5.7G* (Wider definition of certain specified investments when carrying on some kinds of EU business) applies.

See article 84(1A)-(1D) of the *Regulated Activities Order*.

- 2.6.22B G ~~The transposition of *MiFID* does not have the effect of turning spot or forward foreign exchange contracts into *financial instruments* where such instruments satisfy the commercial purpose test in article 84(2) of the *Regulated Activities Order*. In our view, very few instruments are likely to fall within *PERG 2.6.22AG* in practice, given that this category only applies in the case of instruments not falling within *PERG 2.6.22G*. An example of an instrument falling within *PERG 2.6.22AG* could be rights under a contract for a derivative which provides for physical delivery of a commodity at a future date and which is entered into on a multilateral trading facility. [deleted]~~

Contracts for differences

- 2.6.23 G The *specified investment* category of *contracts for differences* covers:
- ...
- (3) ~~other derivative contracts~~ for the transfer of credit risk (not within (1) or (2)) falling within paragraph 8 or 9 of Annex 1 to *MiFID*, ~~that is derivative instruments for the transfer of credit risk~~ (see *PERG 13, Q30* to Q31 for *guidance* about these instruments), but only where ~~a *MiFID investment firm* or a *third country investment firm* provides or performs *investment services and activities* on a professional basis~~ *PERG 2.5.7G* (Wider definition of certain specified investments when carrying on some kinds of EU business) applies.

...

- 2.6.24 G ...

- 2.6.24A G (1) A binary bet is also treated as *contract for differences*. This is defined as something that meets the following conditions:

- (a) it is a derivative contract of a binary nature;

- (b) it is not covered by PERG 2.6.23G(1) or (2);
  - (c) it is settled in cash; and
  - (d) it is a *financial instrument* that falls within paragraphs 4, 5, 6, 7 or 10 of Annex 1 to MiFID (see PERG 13, Q31A to Q34 for guidance about these instruments).
- (2) The main example of this type of product is a binary or digital option.
- (3) The requirement for this type of product to be binary (see PERG 2.6.24AG(1) (a)) means that a contract is only covered if the payout is all or nothing. That is, the overall result will be that one party will pay the other a fixed sum. It is a sort of fixed odds bet.
- (4) A simple example is a contract between X and Y under which:
- (a) at the start, X pays Y a fixed sum (equivalent to the stake in a bet);
  - (b) if shares in ABC PLC close above £5.20 per share at close of trading five days later, Y pays X a fixed sum (a multiple of X's original stake), the result being that Y pays X a fixed sum in net terms;
  - (c) if shares in ABC PLC close at or below £5.20 per share at close of trading five days later, X gets nothing, the result being that X pays Y a fixed sum.
- (5) A fixed odds sporting bet is not covered as such bets are not covered by MiFID and so they do not meet the condition in PERG 2.6.24AG(1)(d).

...

## 2.7 Activities: a broad outline

...

### Bidding in emissions auctions

- 2.7.6B G The RAO and the *auction regulation* together generate three broad categories of *person* in relation to bidding for *emissions allowances* on an *auction platform*:
- (1) The first category consists of an *investment firm* to which *MiFID* applies, ~~and a BCD CRD credit institution and a third country credit institution~~ where ~~either the firm is bidding on behalf of its clients for emissions auction products or bidding on its own account for emissions auction products that are financial instruments.~~ For these purposes a *third country credit institution* refers to a *credit institution*

that would qualify to be a CRD credit institution if its registered or head office were in the EEA.

- (1A) ~~This~~ The first category also consists of a person that is exempt from MiFID under article 2(1) (i) (j) where it is bidding on behalf of a client of its main business or bidding on its own account (further information on the article 2(1) (i) (j) exemption from MiFID is in PERG 13.5, Q44). A person in this category is entitled to bid on an auction platform but requires permission from the FCA for bidding in emissions auctions to do so.
- (2) ~~The second category consists of an investment firm to which MiFID applies and a BCD credit institution where either is bidding on its own account for two day emissions spot. This category also consists of operators or aircraft operators bidding on their own account as well as group entities or business groupings of those operators or public bodies or state-owned entities of Member States that control any of those operators (as set out in article 18 of the auction regulation). A person or entity in this category is entitled to bid on an auction platform but does not require permission from the FCA to do so as a result of an exclusion from the regulated activity of bidding in emissions auctions in article 24B of the RAO.~~
- (3) ...
- (4) Article 24B(2) of the RAO includes in the second category (see (2)) an investment firm to which MiFID applies, a CRD credit institution or a third country credit institution where it is bidding on its own account for emissions auction products that are not financial instruments under MiFID. This part of the RAO no longer has effect as all emissions auction products are financial instruments. When it was brought into force, a two day emissions spot was not a financial instrument.

2.7.6C G A person may fall into both the first and the second category. For example, a person might be both exempt from MiFID under article 2(1)(i)(j) (within the first category) and be a group entity of an operator (within the second category). In this case, that person does not require permission for activities that cause that person to fall into the second category because those activities are excluded from the activity of *bidding in emissions auctions*.

- 2.7.6D G (1) As explained in PERG 2.6.19DG, an emission allowance and an emissions auction product are both specified investments. The Regulated Activities Order deals with this as follows.
- (2) A person in the first category in PERG 2.7.6BG requires permission from the FCA for bidding in emissions auctions but does not require any other permission to do so.
- (3) A person in the second category in PERG 2.7.6BG does not require any permission from the FCA for bidding.

- (4) Article 24A(2) of the RAO is the main provision that deals with (2) and (3). It provides that *bidding in emissions auctions* does not form part of any other *regulated activity* and so, although in the FCA's view ~~this~~ the activity of *bidding in emissions auctions* broadly equates to the *regulated activities* of *dealing in investments as principal*; *dealing in investments as agent*; *arranging (bringing about) deals in investments*; or *making arrangements with a view to transactions in investments*, a person seeking to carry on ~~this~~ bidding activity will ~~only~~ not require permission for *bidding in emissions auctions* any of these other *regulated activities* to do so.
- (5) An *emission allowance* is a *security*. This means that any person wishing to carry out any activity in relation to it will need to consider whether any of the *regulated activities* relating to *securities* apply (subject to (8)).
- (6) A derivative on an *emission allowance* is potentially a *contractually-based investment* and a *relevant investment*. Therefore any person wishing to carry out any activity in relation to it will need to consider whether any of the *regulated activities* relating to *contractually-based investments* and *relevant investments* apply (subject to (8)).
- (7) An *emission allowance* auctioned under the *auction regulation*, as well as being a *specified investment* in its own right (an *emissions auction product*) may also be included in the *emission allowance category of specified investment* (subject to (8)). It is unlikely to be a *contractually based investment* or a *relevant investment*.
- (8) However (as explained in (2) to (4)), for a *firm* that is bidding under the *auction regulation*:
- (a) the only *regulated activity* is *bidding in emissions auctions*;  
and
- (b) the only *specified investment* is an *emissions auction product*.
- (9) (7) means that a *person* may need *permission* to carry out other activities in relation to *emission allowances* that are auctioned under the *auction regulation*, such as:
- (a) buying and selling them in the secondary market; or
- (b) advising a client about buying or selling them.
- (10) Where (9) applies, the *specified investment* involved will be an *emission allowance*. The *emissions auction product category of specified investment* is only relevant to the *regulated activity of bidding in emissions auctions*.
- (11) (9) applies to a *person* in (2) or (3) as well as anyone else wanting to carry out such activities.



~~2.7.6E G As explained in PERG 2.6, both an *emission allowance* and an *emissions auction product* are *specified investments*. The *Regulated Activities Order* deals with this as follows:~~

...

Operating an organised trading facility

...

- 2.7.7DD G (1) ...
- (2) Subject to (3) and (4), a non-equity *MiFID* instrument means:
- (a) *a debenture, an alternative debenture, a government and public security, a warrant, a certificate representing certain securities, a unit, an emission allowance, an option, a future or a contract for differences; or*
  - (b) *rights to or interests in investments* relating to anything in (a).
- (3) However, a product in (2) is only a non-equity *MiFID* investment if it also falls into one of the following categories:
- (a) a bond; or
  - (b) a *structured finance product*; or
  - (c) an emission allowance; or
  - ~~(e)~~ an instrument falling within section C4 to C10 of Annex 1 of (d) *MiFID* (these are described in PERG 13.4) if the instrument is a transferable security.
- ~~(4) An *emission allowance* is also a non-equity *MiFID* instrument.~~

...

## 2 Annex 2 Regulated activities and the permission regime

...

7 Table

Table 3: Securities, contractually based investments and relevant investments [see notes 1 and 2 to Table 3]		
Security (article 3(1))	Contractually based investment (article 3(1))	Relevant investments (article 3(1))
...	...	...

...	<p><i>contract for differences</i> (article 85)</p> <p>For the purposes of the <i>permission regime</i>, <i>contract for differences</i> is subdivided into:</p> <ul style="list-style-type: none"> <li>● <i>contract for differences</i> (excluding a <i>spread bet</i>, a <i>binary bet</i> and a <i>rolling spot forex contract</i>);</li> <li>● <i>spread bet</i>;</li> <li>● <i>rolling spot forex contract</i>; <u>and</u></li> <li>● <u><i>binary bet</i></u>.</li> </ul>	
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### 13 Guidance on the scope of MiFID and CRD IV

#### 13.1 Introduction

...

Background

...

MiFID is complemented by regulation (EU) No. 600/2014 on markets in financial instruments ('MiFIR'). MiFID and MiFIR are supplemented by "Level 2 measures". The most relevant for the purposes of this chapter are Commission Delegated Regulation (EU) xxx/xxx (the *MiFID Org Regulation*) and *RTS 21* (see Q45 for more about this). These implementing measures amplify and supplement certain of the concepts and requirements specified in MiFID and MiFIR.

...

#### 13.2 General

...

**Q11. How will we know whether we are a tied agent (article 4.1(29))?**

A tied agent under MiFID is a similar concept to an *appointed representative* under the *Act*. A tied agent does not require authorisation for the purposes of MiFID, just as an *appointed representative* does not require authorisation under the *Act*. In our view, you will only be a tied agent if your principal is an investment firm (including a credit institution) to which MiFID applies. So, if you act for a principal that is subject to an exemption in ~~either~~ article 2 or 3 of MiFID (as implemented by The Treasury - see Q48 and Q49), you are not a tied agent for the purposes of MiFID although you may be an *appointed representative* for domestic purposes. You will still not require authorisation under MiFID, either because you are not performing investment services and activities or, if you are, because you fall within an exemption in article 2 or 3 of MiFID.

MiFID says that firms exempt under article 3 should be subject to requirements which are at least analogous to the MiFID regime for tied agents of investment firms. This has been implemented in the UK through the *appointed representative* regime. If you are an *appointed representative* of a principal who is exempt under article 3 you will also be exempt under MiFID.

...

### 13.3 Investment Services and Activities

Introduction

#### Q12. Where do we find a list of MiFID services and activities?

...

A further provision relating to investment advice is contained in article 9 of the *MiFID Org Regulation*.

...

Investment advice

...

#### Q19. What is a ‘personal recommendation’ for the purposes of MiFID (article 9 of the *MiFID Org Regulation*)?

A personal recommendation is one ~~given to a person~~ that meets the following conditions:

- it is given to a person in his capacity as an investor, or potential investor, or as agent for either ~~which is:~~ ; and
- the recommendation is:
  - presented as suitable for him or based on a consideration of his personal circumstances; and

- o constitutes a recommendation to him to do one or more of the following:
  - buy, sell, subscribe for, exchange, redeem, hold or underwrite a particular financial instrument; or
  - exercise, or not to exercise, any right conferred by a particular financial instrument to buy, sell, subscribe for, exchange, or redeem a financial instrument.

...

**Q20. Can you give us some other practical examples of what are not personal recommendations under MiFID?**

A recommendation is not a personal recommendation if it is issued exclusively ~~through distribution channels or~~ to the public (article ~~52 9~~ of the *MiFID implementing Directive* *MiFID Org Regulation*) and a ‘distribution channel’ is ~~one through which information is, or is likely to become, publicly available because a large number of people have access to it.~~ Advice about financial instruments in a newspaper, journal, magazine, publication, internet communication addressed to the public in general or radio or television broadcast should not amount to a personal recommendation ~~for the purposes of MiFID (recital 79 to the MiFID implementing Directive).~~ However, use of the internet does not automatically mean that a communication is not a personal recommendation on the grounds that it is made to the public. Therefore, for instance, an email communication provided to a specific person may amount to investment advice.

...

If you provide an investment research service to your clients or otherwise provide recommendations intended for ~~distribution channels or~~ the public generally, this is not MiFID investment advice (A5) although it may be an ancillary service (B5) for the purposes of MiFID and may also amount to the regulated activity of *advising on investments* for which you are likely to require *authorisation*.

**Q21. Is generic advice investment advice for the purposes of MiFID (recitals ~~79 and 81~~ *MiFID implementing Directive* 15 to 17 to the MiFID Org Regulation)?**

...

If you are an investment firm to which MiFID applies, however, the generic advice that you provide may be subject to MiFID-based requirements. For example, if you recommend to a client that it should invest in equities rather than bonds and this advice is not in fact suitable, you are likely, depending on the circumstances of the case, to contravene MiFID requirements to:

- act honestly, fairly and professionally in accordance with the best interests of your clients; and

- provide information to clients that is fair, clear and not misleading.

Acts carried out by an investment firm that are preparatory to the provision of a MiFID investment service or activity are an integral part of that service or activity. This would include the provision of generic advice. Therefore if a person provides generic advice to a client or a potential client prior to or in the course of the provision of investment advice or any other MiFID investment service or activity, that generic advice is part of that MiFID investment service or activity.

Providing a general recommendation about a transaction in a financial instrument or a type of financial instrument is an ancillary service within Section B(5) of Annex I of MiFID.

...

### 13.4 **Financial Instruments instruments**

Introduction

#### **Q27. Where do we find a list of MiFID financial instruments?**

In Section C of Annex 1 to MiFID. There are eleven categories of financial instruments in Section C (C1 to C11). Transferable securities (C1) and money market instruments (C2) are defined in article 4. Further provisions relating to certain of these products are contained in the MiFID Org Regulation.

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Money market instruments

#### **Q28A. What are money market instruments (C2 and article 4.1(17) of MiFID and article 11 of the MiFID Org Regulation)?**

This means those classes of instruments which are normally dealt in on the money market. Examples include treasury bills, certificates of deposit and commercial paper. A money market instrument does not include an instrument of payment.

An instrument is only a money market instrument if it also meets the following conditions:

- it has a value that can be determined at any time;
- it does not fall into sections C4 to C10 of Annex 1 to MiFID (derivatives);  
and
- it has a maturity at issuance of 397 days or less.

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Derivatives: general

#### **Q30. Which types of derivative fall within MiFID scope?**

The scope of derivatives under MiFID includes the following:

- derivative instruments relating to securities, currencies, interest, emission allowances or certain other things (see Q31A to Q31O);
- commodity derivatives (see Q32 to Q33C);
- derivative instruments for the transfer of credit risk (see Q31);
- financial contracts for differences (see ~~Q31A~~ these are included in section C9 of Annex 1 to MiFID); and
- derivatives on miscellaneous underlyings (see Q34).

~~The scope of C4, C8 and C9 these derivatives does not extend to spot transactions, transactions which are not derivatives (such as forwards entered into for commercial purposes) and sports spread bets. In our view, neither C4 nor C9 comprise forward foreign exchange instruments unless they are caught by the scope of the Regulated Activities Order (see *PERG 2.6.22BG*). A non-deliverable currency forward which is not a “future” for the purposes of the Regulated Activities Order because it is made for commercial purposes will likewise fall outside the scope of MiFID.~~

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General financial and emissions derivatives (C4 ~~and C9~~)

**Q31A. Which types of financial derivative fall within this heading?**

The C4 category of financial instruments covers:

- options;
- futures;
- swaps;
- forward rate agreements; and
- any other derivative contracts;

relating to:

- securities;
- currencies;
- interest rates or yields;
- emission allowances; or
- other derivatives instruments, financial indices or financial measures.

A derivative contract is covered whether it is settled physically or in cash.

**Q31B. Is every foreign exchange contract caught by MiFID (article 10 of the MiFID Org Regulation)?**

No. There are two exclusions:

- There is an exclusion for spot contracts (see the answer to Q31C).
- There is an exclusion for a foreign exchange transaction connected to a payment transaction (see the answer to Q31D).

Technically these exclusions relate to the other “any other derivative contracts” type of C4 derivative contract listed in the answer to Q31A. However in the FCA’s view no contract that has the benefit of one of these exclusions could be a C4 future either.

These exclusions do not apply to an option or a swap on a currency, regardless of the duration of the swap or option and regardless of whether it is traded on a trading venue or not (recital 13 to the *MiFID Org Regulation*).

**Q31C. What is the exclusion for foreign exchange spot contracts mentioned in Q31B?**

A contract for the exchange of one currency against another currency is excluded if under its terms delivery is scheduled to be made within a specified number of trading days. The number of trading days depends on the type of contract. For these purposes, there are three types of contract.

The first type of contract is one for the exchange of one major currency against another major currency. The contract is exempt if under its terms delivery is scheduled to be made within two trading days.

The second type of contract is one for the exchange of a non-major currency against either another non-major currency or against a major currency. The contract is excluded if under its terms delivery is scheduled to be made within the longer of:

- two trading days; and
- the period generally accepted in the market for that currency pair as the standard delivery period.

The third type of contract is one for the exchange of one currency against another where the currency that one of the parties buys is to be used for the main purpose of the sale or purchase of a transferable security or a unit in a collective investment undertaking. The contract is excluded if under its terms delivery is scheduled to be made within whichever is the shorter of the following:

- the period generally accepted in the market for the settlement of that security as the standard delivery period; or

- five trading days.

An example of this third category is as follows. Say that X buys a share in Country P for delivery in four days' time (the standard settlement time in Country P for share purchases). X wishes to pay for the shares (and for associated taxes and costs) in local currency. The exclusion applies if X enters into the contract for the purchase of the local currency four or fewer days before the share settlement date.

If a foreign exchange contract falls into the third category (contract for the purpose of purchase of securities) it may also fall into one of the other two categories. As a result there are potentially two maximum delivery periods. Where this is the case, the longer of the two delivery periods applies for the purpose of deciding whether the exclusion applies.

The major currencies for these purposes are the US dollar, euro, Japanese yen, Pound sterling, Australian dollar, Swiss franc, Canadian dollar, Hong Kong dollar, Swedish krona, New Zealand dollar, Singapore dollar, Norwegian krone, Mexican peso, Croatian kuna, Bulgarian lev, Czech koruna, Danish krone, Hungarian forint, Polish złoty and Romanian leu.

All other currencies are non-major currencies for these purposes.

If there is an understanding between the parties to the contract that delivery of the currency is to be postponed beyond the date specified in contract, it is the longer period that is used to calculate the delivery period.

A day is a trading day if it is a day of normal trading in the jurisdiction of both the currencies that are exchanged.

If either of the following conditions is met:

- the exchange of the currencies involves converting them through a third currency for the purposes of liquidity; or
- the standard delivery period for the exchange of the currencies references the jurisdiction of a third currency,

a day is a trading day if it is a day of normal trading in the jurisdiction of both the currencies that are exchanged and also in the jurisdiction of that third currency.

Physical settlement does not require the use of paper money. It can include electronic settlement.

This exclusion only applies if there is a direct and unconditional exchange of the currencies being bought and sold (recital (13) to the *MiFID Org Regulation*). However a contract may still benefit from the exclusion if the exchange of the currencies involves converting them through a third currency.

The exclusion can cover a single contract with multiple exchanges of currencies. In such a contract, each exchange of a currency should be treated separately for



the purpose of the exclusion (recital 13 to the *MiFID Org Regulation*).

**Q31D. What is the second exclusion for foreign exchange contracts mentioned in Q31B?**

A contract is excluded if:

- it is a means of payment (see the answer to Q31E for what this means);
- it must be settled physically (although non-physical settlement is permissible by reason of a default or other termination event);
- at least one of the parties is not a financial counterparty as defined in article 2(8) of *EMIR*;
- it is entered into in order to facilitate payment for identifiable goods, services or direct investment; and
- it is not traded on a trading venue.

**Q31E. What are identifiable goods, services or direct investments as referred to in the answer to Q31D?**

The most straightforward example of what this means is a contract where one of the parties to the contract:

- sells currency to the other party which that other party will use to pay for specific goods or services or to make a direct investment; or
- buys currency from the other party which the first party will use to achieve certainty about the level of payments that it is going to receive;
  - for specific goods or services that it is selling; or
  - by way of a direct investment.

See Example (10) in Q31I (Can you give me some more examples of how the means of payment exclusion referred to in the answer to Q31D works?) for an example of the second type of foreign exchange contract described at the start of this answer (contract to achieve certainty about the level of payments).

The table in the answer to Q31I gives some more examples of what identifiable goods and services means and gives other examples of what is and is not covered by the exclusion. The meaning of direct investment is dealt with later in this answer.

The *MiFID Org Regulation* says that the foreign exchange contract must be a means of payment. Therefore the exclusion requires that not only should the currency contract facilitate payment for identifiable goods, services or direct investment but that it should also be a means of payment. This combined requirement does not mean that there has to be a three-party arrangement between the buyer and seller of goods or services and the foreign exchange supplier. So,

for example, if a UK company (A) is buying goods from an exporter in Germany (B) and is paying in euro and A buys the euro forward from a bank (C), there is no need for C to issue some sort of instrument to B.

Instead this combined requirement means that the currency contract that is to be excluded should facilitate the payment by providing the monies to be paid or received (or the currency equivalent) or that there should be an equivalent close connection between the currency contract and the payment transaction.

Even though there is no requirement for a formal instrument of payment, the exclusion can cover such arrangements. So in the earlier example in this answer dealing with an importer, an exporter and a bank, the exclusion may apply to an arrangement that involves bank C issuing a euro letter of credit at the request of A for the benefit of B.

The reference to goods and services should be interpreted widely. It can cover, for example, intellectual property (such as computer software and patents) and land.

However, in the FCA's view MiFID investments are only covered by the exclusion if they constitute a direct investment. In the FCA's view, making a direct investment means making a capital investment in an enterprise to obtain a lasting interest in that enterprise. A lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise, and an investor's significant influence on the management of the enterprise. In those circumstances, the investor may acquire a MiFID investment (e.g. the shares in the enterprise), but generally the reference to goods, services or a direct investments would not cover a MiFID investment.

The requirement for the investment to be direct does not prevent the investor acquiring an investment in a wholly-owned subsidiary of a holding company by making the investment in the holding company. However this requirement does mean that the investor should acquire its investment from the enterprise or holding company itself rather than by acquiring a stake through the secondary market.

A foreign exchange contract connected to the purchase of a MiFID investment may still be covered by the exclusion for spot contracts if the payment instrument exclusion does not apply. The spot exclusion makes particular provision for purchases of transferable securities and units in a collective investment undertaking (see the answer to Q31C). The result is that the means of payment exclusion does not undermine the specific provisions of the spot contract exclusion dealing with such transactions.

**Q31F. How is an agent treated under the means of payment exclusion referred to in the answer to Q31D?**

This question is about a foreign exchange contract carried out through agents where:

- at least one of the principals is a non-financial counterparty (see the answer to Q31D for what a financial counterparty means); and

- the contract would otherwise meet the exclusion conditions.

If both the agents are financial counterparties and the agents contract with each other on a principal-to-principal basis with back-to-back contracts with their respective clients, the exclusion is not available for the contract between the two agents. It may be available for the contracts between the agent and its client.

If the arrangement is made in such a way that there is a single contract, to which the two principals are party and which is entered into on their behalf by the agents, the exclusion is available even if both the agents are financial counterparties.

**Q31G. How do I know whether the conditions for the means of payment exclusion described in the answer to Q31D are met?**

A financial counterparty (A) selling currency to a client may want to know whether the client (B) is going to use the foreign currency in a way that meets the exclusion conditions. This may be relevant to whether MiFID conduct of business obligations apply.

A non-financial counterparty (A) may sell currency to another non-financial counterparty (B) in circumstances where the currency that A buys is not being used in a way that qualifies for the exclusion. A may therefore want to rely on B using the currency that B purchases in a way that would qualify.

In each example, the application of the exclusion depends on the use to which the other party is going to put the currency.

In these examples A may rely on B's assurances about the purpose of the currency purchase as long as it has no reason to doubt what B says. Such an assurance could be given in several ways:

- Option 1     A may ask B to explain to A what the purpose of the transaction is, leaving it to A to work out whether the exclusion applies.
- Option 2     B may tell A that the exclusion applies to the transaction in question (for instance by way of a representation in the forward contract). A should only rely on such an assurance if satisfied that B is sufficiently expert to understand what the exclusion means.
- Option 3     B may give A an assurance or representation that applies to all foreign exchange transactions that may take place between them from time to time (which might be included in a master agreement governing all forward currency contracts between them). In this case:
  - o     Option 2 (B should have sufficient expertise) applies.
  - o     In addition, A should be satisfied that B has procedures in place for B to consider whether the exclusion applies in particular cases. This may include for example a procedure under which B can:

- tell A that a particular proposed transaction does not qualify for the exclusion; or
- avoid asking A to enter into a contract that will be outside the exclusion.

Where B is an ordinary individual consumer or a small business, A may not be able to rely on B's judgement about whether the exclusion applies. In that case A should decide whether the exclusion applies based on questions A asks B (Option 1).

**Q31H. Can a flexible forward come within the means of payment exclusion described in the answer to Q31D?**

A forward contract may have a flexible delivery date. For example a forward contract may:

- say that delivery can take place at any point in a two-week period rather than on a fixed date; or
- have an expiry date by which delivery has to be taken but part, or parts, of the delivery can take place before that date.

One of the main issues with this sort of contract is whether it should be treated as an option. The means of payment exclusion does not apply to options (see the answer to Q31B for more on this).

A flexible delivery date within a defined and reasonably short window does not make a contract into an option and so these examples can still benefit from the exclusion. If the delivery period is very long, it is doubtful whether the requirement for the contract to facilitate payment for identifiable goods, services or direct investment (see the answer to Q31D) can be met.

These examples provide for delivery of the full amount by the end of the delivery period. There might also be a contract under which the purchaser may choose not to take delivery of part. An example of this kind of foreign exchange contract is as follows:

A UK importer of goods buys from a German seller and has to pay in euro. The importer may not know exactly how much it wants to import during the next quarter but may want to fix its foreign exchange risk in advance. The foreign exchange contract allows the importer to take delivery of no more than it needs to pay the exporter. Any balance not needed to pay for imports is cancelled and is not available to the importer.

In the FCA's view, if the contract meets the other conditions of the exclusion (and in particular the need for there to be identifiable goods or services) the result will be that the contract is not a traditional option but rather a hybrid contract that is in the "any other derivative" contract category listed in the answer to Q31A (Types of C4 derivative contracts). Thus the exclusion potentially applies.

An argument against the availability of the exclusion for this last example is that it does not meet the requirement for the contract to be settled physically. In the FCA's view this argument is not correct because this requirement is aimed at preventing net cash settlement and does not deal with the cancellation of the contract resulting in there being no need for any kind of settlement.

**Q31I. Can you give me some more examples of how the means of payment exclusion referred to in the answer to Q31D works?**

<b><u>Examples of the meaning of identifiable goods and services</u></b>	
<b><u>Example</u></b>	<b><u>Explanation</u></b>
<u>(1) A UK customer (X) of a UK payment institution (Y) has a sterling account with a bank (P) in the United Kingdom and a separate euro bank account with another bank (Q) in the Eurozone. X wishes to pay its supplier in euro in 3 months. X enters into a forward contract with Y and requests that the euro be sent to its euro account with Q rather than directly to the supplier. The sterling that X pays under the foreign exchange contract comes from its account with P. Q makes the payment to the supplier for X.</u>	<u>The exclusion is potentially available as the foreign exchange transaction facilitates payment for identifiable goods, even though Y does not itself pay the suppliers.</u> <u>The exclusion can cover an arrangement in which the firm selling the foreign currency is not the firm that makes the payment.</u>
<u>(2) A UK importer has bought €100,000 worth of goods. The supplier has not yet issued an invoice and the sum is not yet due from the importer. However the importer knows the price. It buys the euro forward.</u>	<u>The issue here is whether the forward exchange contract relates to identifiable goods as referred to in the answer to Q31D.</u> <u>The exclusion is potentially available. There is no need for the invoice to have been issued or the price yet to be due.</u>
<u>(3) A UK importer of goods has ordered a specific quantity of an identified type of goods from the supplier. The price will be payable in euro but the euro price has not yet been fixed. The UK importer makes an estimate of the euro price and buys the euro forward.</u>	<u>The issue here is whether the forward exchange contract relates to identifiable goods as referred to in the answer to Q31D.</u> <u>The exclusion is potentially available.</u> <u>There is no need for the amount to be paid under the foreign exchange contract to match precisely the amount of the payment that it is facilitating. An estimate is permissible. The goods are specifically identifiable by purchase order.</u>
<u>(4) A UK importer knows that it wants to purchase €100,000 worth of goods from an identified Eurozone supplier in the next quarter but it has not yet entered into a formal contract with the supplier. It buys the</u>	<u>The issue here is whether the forward exchange contract relates to identifiable goods as referred to in the answer to Q31D.</u> <u>The exclusion is potentially available. There is no need for the contract for the supply of</u>

<p><u>euro forward.</u></p>	<p><u>goods to have been entered into at the time of the currency purchase.</u></p> <p><u>The goods are specifically identifiable by type, price and supplier and by the purpose for which the importer is buying them.</u></p>
<p><u>(5) A UK importer knows that it wants to purchase €100,000 worth of goods from a Eurozone company in the next year, but does not know from which specific supplier it is going to purchase them. It knows which goods it wishes to buy. It buys the euro forward.</u></p>	<p><u>The issue here is whether the forward exchange contract relates to identifiable goods as referred to in the answer to Q31D.</u></p> <p><u>The exclusion is potentially available.</u></p> <p><u>The goods are specifically identifiable by type and price and by the purpose for which the importer is buying them.</u></p>
<p><u>(6) A UK importer of goods wishes to buy currency in order to allow it to pay for goods in the next quarter. It does not know precisely how many of the goods it will want or what their exact price will be. However it has a sufficiently good idea of the amount of goods to make it unlikely that its estimate will be seriously wrong. It knows this because it has an established practice of buying these sorts of goods.</u></p>	<p><u>The issue here is whether the forward exchange contract relates to identifiable goods as referred to in the answer to Q31D.</u></p> <p><u>The exclusion is potentially available.</u></p> <p><u>The exclusion may be available even though the precise details of the goods to be bought are not yet known.</u></p> <p><u>In this example the goods are identifiable by reference to an established practice and need.</u></p>
<p><u>(7) A firm wishes to import goods for a project and needs foreign exchange to pay for them. It does not know precisely how many of the goods it will buy or what their exact specification will be. However it knows broadly what goods it needs. In this example it knows all this because the goods are needed for a specific purpose in a specific project.</u></p>	<p><u>The issue here is whether the forward exchange contract relates to identifiable goods as referred to in the answer to Q31D.</u></p> <p><u>The exclusion is potentially available.</u></p> <p><u>The exclusion may be available even though the precise details of the goods to be bought are not known yet.</u></p> <p><u>In this example the goods are identifiable by reference to an established project and a particular purpose within that project.</u></p>
<p><u>(8) A customer wants to hedge its balance sheet because it has a euro exposure but reports financially in sterling.</u></p>	<p><u>The exclusion is not available as the foreign exchange contract is not entered into in order to facilitate payment for identifiable goods or services.</u></p> <p><u>If, as is likely to be the case, the foreign exchange contract is a swap or a non-deliverable forward, that is another reason for the exclusion not being available as the exclusion does not apply to this sort of contract (see the answers to Q31B and Q31N).</u></p>

<p><u>(9) A customer wishes to undertake a sterling/euro conversion to purchase €100,000 in three months. This amount is to cover 20 individual payments of €5,000 which will be drawn down at different times.</u></p> <p><u>This type of contract benefits the customer who obtains a better rate by setting up one contract for a larger value than could be obtained on 20 individual low value contracts.</u></p>	<p><u>The exclusion is potentially available. See the answer to Q31H.</u></p>
<p><u>(10) An exporter (A) sells goods to a French importer for payment on delivery in euros. A, before the due date for payment for the goods, sells the euro for the equivalent amount in sterling. The foreign exchange contract is made at the applicable forward rate on the date of the currency contract. Settlement of the currency contract is due on the same day as payment for the goods. A is thereby protected against adverse movements in sterling against the euro.</u></p>	<p><u>The exclusion is potentially available. Recital 10 to the MiFID Org Regulation says that a contract to achieve certainty about the level of payments for identified goods is covered by the exclusion.</u></p>
<p><u>(11) A UK importer (A) has bought €100,000 worth of goods from several suppliers. A has a number of purchase contracts with each supplier and each supplier has issued a number of invoices. The due dates for payment on each invoice are quite close together and so A buys €100,000 forward from one provider in a single contract.</u></p>	<p><u>The exclusion is potentially available. There is no need for there to be a single currency contract for each contract under which payment arises. Nor do the payment dates have to match exactly between the purchase contracts and the forward contract.</u></p>
<p><u>(12) A UK importer (A) has bought €100,000 worth of goods. A buys €100,000 forward from several currency providers.</u></p>	<p><u>The exclusion is potentially available. There is no need for A to use a single currency provider.</u></p>
<p><u>(13) A UK importer (A) has bought €100,000 worth of goods from several suppliers. A has a number of purchase contracts with each supplier and each supplier has issued a number of invoices. The due dates for some of the invoices are quite close together and so A buys €50,000 forward from one provider in a single contract to meet these payment obligations. The result is that €50,000 is allocated between a number of import contracts in differing amounts and none of the import contracts are covered in full.</u></p> <p><u>A decides to meet the other €50,000 from its</u></p>	<p><u>The exclusion is potentially available. The exclusion may apply even where the excluded currency contract is applied to a number of different payment obligations under a number of import contracts.</u></p> <p><u>The exclusion is available even if A relies on its own resources for part of the payment transaction.</u></p>

<u>own resources.</u>	
<u>(14) A UK importer (A) has bought €40,000 worth of goods from one supplier and €60,000 from another. The suppliers have issued invoices but payment is not yet due from A. A buys €40,000 forward to meet the payment on the first and decides to meet the €60,000 due under the other contract from its own resources.</u>	<u>The exclusion is potentially available. There is no requirement that A should cover every contract for goods to which the exclusion might apply.</u>
<u>(15) A UK importer (A) has bought €100,000 worth of goods. The supplier has issued an invoice but the sum is not yet due from A. A buys €200,000 forward. A will use other €100,000 for purposes that do not meet the exclusion conditions.</u>	<u>The exclusion is not available where A uses part of the currency it buys for purposes that do not meet the conditions of the exclusion.</u>
<u>(16) A UK importer (A) has bought €100,000 worth of goods. The supplier has issued an invoice but the sum is not yet due A. A decides to meet the payment out of its own resources. Later A changes its mind and buys the €100,000 forward.</u>	<u>The exclusion is potentially available. The date of the currency contract and the contract generating the payment obligation do not need to be entered into at the same time.</u>
<u>(17) A UK importer (A) has bought €100,000 worth of goods. The supplier has issued an invoice but the sum is not yet due from A. A buys the US dollar equivalent of €100,000 forward.</u>	<u>The exclusion will not generally be available because the currency contract is not a means of payment facilitating the payment due from A to the supplier.</u>
<u>(18) A UK importer (A) has bought €100,000 worth of goods. The supplier has issued an invoice but the sum is not yet due from the importer. A buys the €100,000 forward. Later A buys another €100,000 forward</u>	<u>The exclusion is not available for the second contract. The first contract should be taken into account when deciding whether A may rely on the exclusion for second contract.</u> <u>See the answer to Q31J for an example of where the exclusion can apply.</u>
<u>(19) A farmer's farm payment under the EU basic payment scheme will be €10,000 and will be paid in sterling. The payment will be made in three months' time. In order to fix the sterling amount they will receive, the farmer wishes to book a forward with a currency provider to sell €10,000 and buy sterling in three months' time.</u>	<u>The issue here is whether the forward exchange contract relates to identifiable goods and services as referred to in the answer to Q31D.</u> <u>The exclusion is not available because the payment is not linked to any specific goods or services being sold or bought by the farmer.</u> <u>It is unlikely that the farmer will be carrying on MiFID business for the reasons described in the answer to Q7 (We provide investment</u>



	<p><u>services to our clients. How do we know whether we are an investment firm for the purposes of article 4.1(1) MiFID?).</u></p>
<p><u>(20) An overseas student is given a grant by their home country in their local currency to study at a UK university, payable in six months' time. As the fees are payable in sterling, the student wishes to book a forward with a currency provider to sell their home state currency and buy sterling in six months' time. They wish to enter into the forward contract to guarantee the amount of sterling they will receive.</u></p>	<p><u>The issue here is whether the forward exchange contract relates to identifiable goods and services as referred to in the answer to Q31D.</u></p> <p><u>The exclusion may be available because the grant helps the student to pay for the UK university's fees.</u></p> <p><u>The exclusion is still available if some of the grant is to meet living costs and the student has not yet decided what exactly they will need to buy (see the answer to Q31M (holiday spending money) for more on this).</u></p>
<p><u>(21) A hedge fund manager has investors in the UK and a fund which is made up of euro denominated securities. The value of the fund to the investor will fluctuate due to the market value of the securities but it will also go up or down in accordance with the euro/sterling exchange rate. The fund manager seeks to hedge this risk by purchasing a forward contract to sell euro and buy sterling for three months in the future. The purpose of the trade is to ensure the investors will not be subject to currency volatility affecting the value of their investment.</u></p>	<p><u>The exclusion is not available because the payment to the investors is not linked to any specific goods, services or direct investment.</u></p>
<p><u>(22) A UK importer (A) wishes to buy some machinery from a Eurozone seller in three months for €500,000. A enters into a three-month forward for the purchase of €500,000 using sterling. However, the machinery purchase is delayed and A asks to extend the forward contract. This may involve A paying more money for the euro depending on the exchange rate at the date of the contract extension.</u></p>	<p><u>The fact that the currency forward is later amended by mutual consent to match the changed payment date for the machinery does not prevent the exclusion from applying as long as the amended version meets the exclusion conditions in the light of the changed circumstances.</u></p> <p><u>If the foreign exchange provider refuses to amend the contract the exclusion is not lost as long as the exclusion conditions were met at the time the foreign exchange contract was entered into.</u></p>
<p><u>(23) A UK importer (A) wishes to buy some machinery from a Eurozone seller in three months for €500,000. A enters into a three-</u></p>	<p><u>The answer to (22) applies.</u></p>

<p><u>month forward for the purchase of €500,000 using sterling.</u></p> <p><u>The machinery purchase falls through but A wants to extend the contract length as they have identified replacement machinery with a similar price.</u></p>	
<p><u>(24) A UK importer (A) wishes to buy some machinery from a Eurozone seller in three months for €500,000. A enters into a three-month forward for the purchase of €500,000 using sterling. However, the machinery purchase is delayed and the specifications are changed. The currency contract therefore no longer facilitates payment under the machinery contract. A decides to close out the existing currency contract. A also enters into a new forward contract with another currency provider that matches the revised machinery contract.</u></p>	<p><u>The exclusion is potentially available for the close out contract and also for the new currency contract.</u></p> <p><u>If A decides to meet the payment due under the revised machinery contract out of its own resources, the exclusion is still potentially available for the close out contract.</u></p>
<p><u>(25) A customer is due to receive an inheritance in euro and is advised of the amount but, owing to the need to complete probate, the funds will not be released for a number of months. The customer wishes to ensure that there is no depreciation in value of the inheritance in sterling terms and enters into a euro-sterling forward.</u></p>	<p><u>The exclusion is not available because the foreign exchange contract is not linked to any specific goods, services or direct investment.</u></p>
<p><u>(26) A UK parent company wishes to inject capital in euro into a European subsidiary in four months' time and enters into a forward contract to purchase the euro.</u></p>	<p><u>The exclusion is potentially available as the foreign exchange contract is made to facilitate a direct investment in the subsidiary.</u></p>
<p><u>(27) A customer asks a UK payment institution to make a payment to a family member living abroad. The payment is to be made in the currency of the country where the family member lives. The customer buys the foreign currency on a forward basis.</u></p>	<p><u>The exclusion is not necessarily available. The exclusion is only available if the family member is going to use the currency for a purpose that comes within the exclusion.</u></p>
<p><u>(28) A UK firm (A) has employees abroad. A pays them in local currency. A buys forward the currency with which it will pay its employees.</u></p>	<p><u>The exclusion potentially applies.</u></p>

**Q31J. How do the examples in the table in the answer to Q31I apply to an exporter or importer with a large portfolio of contracts?**

This question deals with the fact that the examples in the table in the answer to Q31I have relatively simple examples where the purchaser of the foreign currency only has one or a few payment obligations. In many cases a seller or buyer of goods will have frequent payment transactions for which it needs foreign exchange and it may not wish to meet this need by having a separate currency contract for each import or export contract.

The exclusion can still apply in these cases. This is because, as the examples in the table in the answer to Q31I show, there is some flexibility in the amount and timing of currency contracts, the ability to estimate currency needs, the ability to close out currency contracts and the use of different currency providers.

However the requirements of the exclusion still apply, including the need to show that the currency contract is a means of payment that is entered into in order to facilitate payment for identifiable goods, services or direct investment. This means that it will be necessary to look at all the importer or exporter's incoming and outgoing payments and currency resources each time the importer or exporter enters into a new currency contract to see whether the exclusion is available for that new currency contract.

Say:

- a UK importer (A) has bought €100,000 worth of goods under a contract with a Eurozone supplier (Contract P);
- the supplier has issued an invoice but the sum is not yet due from A;
- A buys the €100,000 forward; and
- later A buys another €100,000 forward.

It is possible that the second currency contract may facilitate the payment under Contract P and thus be used to justify the application of the exclusion to the second currency contract. Each time A enters into a currency contract to which the exclusion could apply it is necessary to look at all A's incoming and outgoing payments and currency resources. If A (or the currency provider) relied on Contract P to take advantage of the exclusion for the first currency contract, that does not mean that the first currency contract cannot be used to justify the application of the exclusion to a later goods contract: the first currency contract is not tied to the payment under Contract P for all time. When A enters into the second currency contract, changes to Contract P or to A's payment profile mean that:

- the new currency contract will better facilitate the payment obligation under Contract P and the first currency contract will facilitate another payment obligation; or
- the first contract no longer facilitates the payment under Contract P and A needs the new currency contract to allow it to make the payments due under Contract P.

**Q31K I am a payment services provider under the Payment Services Regulations. How do the spot contract and means of payment exclusions referred to in the answers to Q31C and Q31D apply to me?**

(See PERG 15 (Guidance on the scope of the Payment Services Regulations 2009) for the Payment Services Regulations)

This answer only relates to a payment service provider authorised under the *Payment Services Regulations*. It does not cover, for example, banks that are subject to the conduct of business requirements of those Regulations.

The *Payment Services Regulations* allow you to provide foreign exchange services that are closely related and ancillary to your payment services. That right does not allow you to provide foreign exchange derivative services that would otherwise require authorisation under MiFID. You therefore need to consider the availability of MiFID exclusions for your foreign exchange business.

The most common sort of foreign exchange contract you are likely to carry out is where you execute a payment for your customer that involves a currency conversion. For example, you may make a payment for your customer in euros from the customer's sterling payment account to a payee's payment account. The foreign exchange part of this transaction is separate from the payment part of the transaction (see Q12 in PERG 15.2 (We provide electronic foreign exchange services to our customers/clients. Will this be subject to the PSD regulations?)).

The foreign exchange part of this example may involve a MiFID C4 derivative if it has a forward element. However in practice it is likely that such foreign exchange transactions will fall outside MiFID because there is no forward element or the spot exclusion applies.

The following are examples of how the delivery period should be calculated for the MiFID spot exclusion. They are all based on a payment being made in one currency from a payment account in another currency.

- If your customer asks for the payment to be made immediately, the delivery period starts on the date of request.
- If your customer asks for the payment to be made some time after the request and the foreign exchange conversion is to be carried out at the spot rate on the transfer date, the delivery period starts on that transfer date entered into.
- If your customer asks for the payment to be made some time after the request and the foreign exchange conversion rate is fixed on the date the customer gives you your instructions, the delivery period starts on that instruction date.
- The date on which the payment is received by the payee's payment services provider should normally be treated as the delivery date.
- If you debit your customer's payment account after receipt by the payee's

payment services provider and the foreign exchange conversion rate is fixed on the debit date, the debit date should be treated as the delivery date.

If your customer wants to make a foreign currency transfer some time in the future and buys the foreign currency from you in advance at the spot rate and immediately credits it to a payment account with you, the spot exclusion should apply.

If the delivery period is too long for the spot contract exclusion to apply, the means of payment exclusion is potentially available because you are not a financial counterparty for the purposes of that exclusion.

However, the means of payment exclusion only applies if the payment by your customer meets the requirements about identifiable goods, services or direct investments described in the answer to Q31D.

**Q31L. Can a non-deliverable forward come within the exclusion for spot foreign exchange contracts in the answer to Q31C (recital (12) of the MiFID Org Regulation) or the means of payment exclusion in the answer to Q31D?**

No.

A non-deliverable forward is a cash-settled foreign exchange contract relating to a thinly traded or non-convertible foreign currency against a freely traded currency. The first currency may be non-convertible for example because of exchange controls or restrictions on currency dealing. On the contracted settlement date, the profit or loss is adjusted between the two counterparties based on the difference between the contracted rate for the non-deliverable currency and the prevailing spot rate. The price for the convertible currency may be expressed in terms of a second convertible currency.

As settlement is for the difference between an exchange rate agreed before delivery and the actual spot rate at maturity, a non-deliverable forward is not a spot contract, regardless of the settlement period. The means of payment exclusion is also not available. See the answer to Q31N about why settlement for a difference does not come within either exclusion.

**Q31M. How is holiday spending money treated under the spot contract and means of payment exclusions referred to in the answers to Q31C and Q31D?**

One way of buying holiday currency is for the holidaymaker to order currency to be collected, for example, a week after the order, to be paid for at the currency seller's spot rate on the day of collection. This contract is not a MiFID investment either because it does not fall into the category C4 type of derivative in the first place or because the spot contract exclusion described in the answer to Q31C applies.

Another way of buying holiday money is for the holidaymaker to order currency to be collected, for example, a week after the order, to be paid for at the currency seller's spot rate on the day the currency is ordered. This type of contract is

potentially within the C4 type of derivative. However the means of payment exclusion is potentially relevant. The holiday can be treated as identifiable goods or services even though the holidaymaker may not know what restaurant they are going to eat at or what tourist attractions they are going to visit.

In either case the seller of the holiday money may agree to buy back any unused currency at a price fixed at the same time as the rate at which the holidaymaker is to buy the currency is fixed and linked to the original rate. Such an arrangement may also benefit from the means of payment exclusion. This is because the promise to buy back the currency is so closely connected to the original purchase that it can be seen as being an integral part of the same transaction.

These answers are relevant to whether the currency seller requires authorisation under MiFID. The holidaymaker will not require authorisation because their regular occupation or business will not include the provision of investment services in relation to MiFID financial instruments to others on a professional basis (see the answer to Q7 for more about this).

**Q31N. How does netting affect the exclusions for foreign exchange contracts in the answers to Q31C and Q31D?**

A foreign exchange contract may involve a valuation of the currencies being bought and sold for the purposes of settlement and a single payment being made.

The spot contract exclusion described in the answer to Q31C requires there to be exchange and delivery. The means of payment exclusion described in the answer to Q31D requires there to be physical settlement delivery. Therefore neither exclusion applies to a contract involving this type of netting. An instrument that provides for a single payment like this is more like a swap, which is outside the scope of the exclusions.

The fact that a foreign exchange contract provides for early termination and netting on default does not mean that the exclusions cannot apply. Similarly, the existence of force majeure provisions dealing with bona fide inability to settle physically does not prevent a contract from benefiting from the exclusions.

The parties to a foreign exchange contract may also have entered into other foreign exchange or financial contracts with each other. The result may be that the parties exchange multiple cash flows during a given day. In order to reduce operational and settlement risks they may agree to net those cash flows into one payment for each currency (payment netting). For example the parties may each have to make and receive multiple payments in sterling, euro and US dollars on the same day. The result of payment netting is that there will only be three payments to be made, one in each of the three currencies. This sort of payment netting is compatible with the exclusions.

**Q31O. I enter into my foreign exchange contracts on a trading venue. What exclusions or exemption can I rely on?**

The spot contract exclusion described in the answer to Q31C may be available.

The means of payment exclusion described in the answer to Q31D will not be available.

You may also find the own account exemption described in the answer to Q40 helpful. Although that exemption is usually disapplied for those who have direct electronic access to a trading venue, this is not the case where the contract is for hedging purposes.

Commodity derivatives

### **Q32. Which types of commodity derivative fall within MiFID scope?**

Broadly speaking, the following commodity derivatives fall within the scope of MiFID:

- ...
- ~~cash-settled commodity derivatives (including physically settled derivatives that provides for settlement in cash at the option of one of the parties other than in the event of default or termination as explained in more detail in Q33A) (C5);~~
- ~~physically settled commodity derivatives traded on a *regulated market* or MTF certain markets or facilities (as explained in more detail in Q33B) (C6); and~~
- ~~other commodity derivatives capable of physical settlement and not for commercial purpose, that is standardised contracts subject to clearing house or margin arrangements so long as they fall into one of the following categories purposes (as explained in more detail in Q33C) (C7):~~
  - ~~instruments traded on a non-EEA trading facility that performs an analogous function to a *regulated market* or MTF;~~
  - ~~instruments expressly stated to be traded on or subject to the rules of a *regulated market*, MTF or a non-EEA trading facility that performs an analogous function; or~~
  - ~~back-to-back contracts with clients or counterparties equivalent to contracts traded on a *regulated market*, MTF or such a non-EEA trading facility.~~

### **Q33. What is a commodity for the purposes of MiFID?**

“Commodity” means any goods of a fungible nature that are capable of being delivered, including metals and their ores and alloys, agricultural products and energy such as electricity (article ~~2.4~~ 2.6 of the ~~*MiFID-Regulation*~~ *MiFID Org Regulation*). The fact that energy products, such as gas or electricity, may be “delivered” by way of a notification to an energy network (such as notifications under the Network Code or the Balancing and Settlement Code) does not prevent them being “capable of being delivered” for these purposes. If a good is freely

replaceable by another of a similar nature or kind for the purposes of the relevant contract (or is normally regarded as such in the market), the two goods will be fungible in nature for these purposes. Gold bars are a classic example of fungible goods. In our view, the concept of commodity does not include services or other items that are not goods, such as currencies or rights in real estate, or that are entirely intangible (~~recital 26 of the MiFID Regulation~~).

**Q33A. Can you tell me more about category C5 commodity derivatives?**

This type of commodity derivative is one that must be settled in cash or one that provides for settlement in cash at the option of one of the parties. A derivative that only allows a party to opt for cash in the event of default or termination is not included.

**Q33B. Can you tell me more about category C6 commodity derivatives?**

This type of commodity derivative is one that:

- can be physically settled; and
- is traded on a regulated market, an MTF or an OTF.

The category C6 type of commodity derivative excludes a wholesale energy product traded on an OTF that must be physically settled.

Article 6 of the MiFID Org Regulation has special definitions for what types of oil, coal and wholesale energy products are included in the C6 category of commodity derivative.

A contract that can be physically settled but which is not traded on a regulated market, MTF or OTF might still fall within the C5 category of commodity derivative even though it falls outside category C6.

**Q33C. Can you tell me more about category C7 commodity derivatives (recital 5 to, and article 7 of, the MiFID Org Regulation)?**

This type of commodity derivative is one that meets all the following conditions:

- It can be physically settled.
- It is not a spot contract. A spot contract means one under the terms of which delivery is scheduled to be made within the longer of the following periods:
  - two trading days;
  - the period generally accepted in the market for that commodity, asset or right as the standard delivery period.

For these purposes a contract is not a spot contract where, irrespective of its explicit terms, there is an understanding between the parties to the contract that delivery of the underlying is to be postponed and not to be



performed within the spot period described earlier in this answer.

- It meets one of the following criteria:
  - it is traded on a non-EEA trading venue that performs a similar function to a regulated market, an MTF or an OTF (an “equivalent third country trading venue”); or
  - it is expressly stated to be traded on, or is subject to the rules of, a regulated market, an MTF, an OTF or an equivalent third country trading venue; or
  - it is equivalent to a contract traded on a regulated market, MTF, OTF or equivalent third country trading venue. Equivalence is judged by reference to the price, the lot, the delivery date and other contractual terms such as quality of the commodity or place of delivery.
- It is standardised so that the price, the lot, the delivery date and other terms are determined principally by reference to regularly published prices, standard lots or standard delivery dates.

Certain contracts entered into with or by an operator or administrator of an energy transmission grid, energy balancing mechanism or pipeline network are excluded from the C7 category of commodity derivative.

Miscellaneous derivatives (C10)

#### **Q34. What types of derivatives fall into this category?**

There is a miscellaneous category of derivatives in C10, which is supplemented by articles ~~38~~ 7 and ~~39~~ 8 of the ~~MiFID Regulation~~ MiFID Org Regulation. These relate to:

...

- an allowance, credit, permit, right or similar asset which is directly linked to the supply, distribution or consumption of energy derived from renewable resources (unless it is included in the C4 category of commodity derivative);
- a geological, environment or other physical variable (excluding an emission allowance);
- any other asset or right of a fungible nature, other than a right to receive a service, that is capable of being transferred; ~~or~~
- an index or measure related to the price or volume of transactions in any asset, right, service or obligation; or
- an index or measure based on actuarial statistics.

C10 derivatives must also meet at least one of the following criteria:

- ...
- the contract is traded in a *regulated market*, ~~or~~ an MTF, an OTF or a non-EEA trading venue that performs a similar function; or
- the contract ~~is standardised, subject to clearing house or margin arrangements and falls into one or more of the categories described under the fourth bullet point in Q32 above~~ meets the following criteria in the answer to Q33C:
  - o it is not a spot contract;
  - o it meets the requirements about trading on (or being stated to be traded on), being subject to the rules of or being equivalent to contracts traded on, certain trading venues;
  - o standardisation; and
  - o it does not fall within the exclusion about transmission grids, energy balancing mechanisms or pipeline networks.

~~In relation to *emissions auction products*, recital 14 together with the definitions of ‘two day spot’ and ‘five day future’ in article 3(3) and 3(4) of the *auction regulation*, indicate that a ‘five day future’ (one of two forms of auction product permitted under the *auction regulation*) falls within this category of derivative.~~

A contract of insurance or reinsurance is not a C10 commodity derivative (recital 6 to the *MiFID Org Regulation*).

Emission allowances

#### **Q34A. How are emission allowances treated?**

They are covered in four ways:

...

~~There is no explanation about~~ It is not always clear how all this overlapping legislation fits together but in the FCA’s view, they work it works like this:

...

- (4) ...
- (5) ~~The *auction regulation* covers the reception, transmission and submission of a bid. This corresponds to the MiFID activities of the reception and transmission of orders in relation to one or more financial instruments, execution of orders on behalf of clients and dealing on own account.~~
- (5) The auction regulation provides certain exemptions for aircraft operators

- (6) ~~and others~~ operators of plant and other installations. These exemptions continue to apply whether or not a MiFID exemption is available, but only for bidding activities covered by the auction regulation.
- (6) Thus for example, article 18 of the auction regulation allows business groupings of operators in (5) to submit bids. The MiFID exemption in (12) below (or the optional exemption in article 3 of MiFID described in the answers to Q48 to Q53) may not cover all such persons but they are still entitled to submit bids under the auction regulation without obtaining MiFID authorisation.
- (7) The mere fact of being exempt under MiFID does not allow someone to bid under the auction regulation. The auction regulation regulates who can and cannot bid.
- (8) The auction regulation covers the reception, transmission and submission of a bid. This corresponds to the MiFID activities of the reception and transmission of orders in relation to one or more financial instruments, execution of orders on behalf of clients and dealing on own account.
- (9) Therefore the auction regulation activities of receiving, transmitting and submitting a bid are all also covered by MiFID, whether the emission allowance is auctioned as a five-day future or a two-day spot contract. However, a person exempt under (5) is not subject to MiFID when bidding (subject to (10)).
- (10) If a person who is exempt under the auction regulation is authorised under MiFID (because for example it wants to carry out other activities for which it needs MiFID authorisation), MiFID will apply to its bidding activities.
- (7) The MiFID activities that apply to a product covered by the auction regulation are not limited to the MiFID activities listed in paragraph (5) (8)
- (11) of this list. All the MiFID investment services and activities apply to emissions allowances auctioned as a financial instrument. Therefore, for example, advising on bids for emissions allowances auctioned as a five-day future is covered by MiFID.
- (12) Article 2.1(e) of MiFID exempts an operator with compliance obligations under Directive 2003/87/EC (Emissions Trading Scheme) from MiFID.
- (a) The exemption covers some of the same ground as the exemption in the auction regulation described in (5) to (7) above. However this overlap neither extends nor narrows the effect of the auction regulation exemption.
- (b) The article 2.1(e) exemption also covers activities not covered by the auction regulation exemption. So, for example, the article 2.1(e) exemption covers buying and selling the underlying emission allowance or the five-day future or two-day spot auction product in the secondary market.

(c) See Q35A for more details about the conditions of the exemption.

...

### 13.5 Exemptions from MiFID

...

**Q35A. Can you give me a complete list of exemptions?**

Description of exemption	MiFID reference	Guidance in this chapter
...		
An operator with compliance obligations under Directive 2003/87/EC (Emissions Trading Scheme) who, when dealing in emission allowances, does not: ...	article 2.1(e)	None <u>Q34A</u>
...		
<del>Own account dealing in</del> <u>Activities relating to commodity derivatives</u>	article 2.1(j)	Q44 to Q46
...		

...

**Q37. We are a non-financial services group company providing investment services to other companies in the same group. Are we exempt under the group exemption in article 2.1(b)?**

Yes, if you provide these services exclusively for your parent company, your subsidiaries and those of your parent company. ~~This means that providing investment services for the benefit of group companies must be the only investment service that you undertake.~~ The exemption is narrower than the corresponding exclusion in article 69 of the Regulated Activities Order (groups and joint enterprises) insofar, for example, as it does not apply to investment services supplied to a joint venture participant (see *PERG* 2.9.10G).

**Q38. We also buy and sell financial instruments for ourselves. Are we still able to use the group exemption?**

Yes. ~~The group exemption applies to investment services and not investment activities. So, as~~ As long as your own account dealing does not involve you providing an investment service (to which MiFID applies) to non-group entities, you can still rely on the group exemption in respect of the services you provide

solely to other group companies.

So far as your own account dealing is concerned, you may be able to rely upon the exemption in ~~article 2.1(i)~~ 2.1(d) (see Q39) or 2.1(j) (see Q44 and Q45) if you meet the relevant conditions. The ability to combine reliance on article 2.1(b) and ~~article 2.1(i)~~ articles 2.1(d) or 2.1(j) could be relevant to companies performing group treasury functions.

The answer to Q46 (Is it possible to combine article 2 exemptions?) explains why it is possible to combine exemptions.

Incidental services as part of a professional activity

**Q39. We provide investment services as a complement to our main professional activity. Are we exempt (article 2.1(c) of MiFID and article 4 of the MiFID Org Regulation)?**

Yes, you will be exempt under article 2.1(c) MiFID if:

- you provide these services ~~in an incidental manner~~ in the course of your professional activity;
- a close and factual connection exists between your professional activity and the provision of the investment service to the same client, such that the investment service can be regarded as accessory to your main professional activity;
- the provision of investment services to the clients of your main professional activity does not aim to provide a systematic source of income to you;
- you do not market or otherwise promote your ability to provide investment services, except where these are disclosed to clients as being accessory to your main professional activity; and
- ~~that~~ your professional activity is regulated by legal or regulatory provisions or a code of ethics that do not exclude the provision of investment services.

...

**Q40. We regularly buy and sell financial instruments ourselves but never as a service to third parties. Are there any exemptions which might apply to us?**

...

~~You cannot rely, however, on the article 2.1(d) MiFID exemption if you provide any investment services or activities other than dealing on own account. If buying and selling MiFID financial instruments is not your main business, or, as the case may be, the main business of your group, you might though wish to consider further the exemption in article 2.1(i) MiFID (see Q44 and Q45).~~

This exemption does not apply to dealing on own account in commodity derivatives, emission allowances ~~derivatives~~ or derivatives on ~~either of those products~~ emission allowances (the exemption discussed in the answer to Q44 (Own account dealing in commodity derivatives) is relevant instead).

As mentioned earlier in this answer, normally the exemption is not available for dealing on a regulated market or on another trading venue. However there is an exception to this. The article 2.1(d) exemption can still be available if you are a member of, or a participant in, a regulated market or an MTF or you have direct electronic access to a trading venue, as long as:

- you are a non-financial entity; and
- your transactions are objectively measurable as reducing risks directly relating to your commercial or treasury financing activity, or the commercial or treasury financing activity of your group.

The second condition (objectively measurable reduction of risks) is designed to allow a business to hedge without losing the exemption. The following points are relevant to whether hedging meets this second condition:

- The exception covers hedging for commercial activities as well as financial activities. It can therefore cover risks to a change in value of your group's assets, services, inputs, products, commodities or liabilities.
- Hedging may cover potential indirect impacts on your business as well as direct ones.
- A transaction may qualify as risk-reducing taken on its own or in combination with other hedging transactions.
- A transaction may be treated as risk-reducing even though it is not a perfect hedge. Thus for example your group may use proxy hedging through a closely correlated instrument to cover an exposure, such as an instrument with a different but very close underlying in terms of economic behaviour.
- If your group uses portfolio or macro hedging, it may not be able to establish a one-to-one link between a specific hedging transaction and a specific risk directly related to the commercial and treasury financing activities being hedged. The risks related to the commercial and treasury financing activities may be complex. For example, the risks may cover several geographic markets, products, time horizons or entities. Nevertheless, macro or portfolio hedging used to hedge a risk in relation to your group's overall risks may be treated as risk-reducing.
- Positions do not qualify as risk-reducing solely on the grounds that they form part of a risk-reducing portfolio on an overall basis. In such cases your group's risk management systems should prevent such transactions from being categorised as risk-reducing.

- A risk may evolve over time and, in order to adapt to the evolution of the risk, a hedging transaction initially executed for reducing risk may have to be offset through the use of additional hedging transactions. As a result, hedging of a risk may be achieved by a combination of hedging transactions and offsetting transactions that close out earlier hedging transactions that have become unrelated to the risk.
- If a transaction originally qualifies as risk-reducing it does not stop being treated as risk-reducing just because the risk it hedges has since evolved.
- A transaction may be treated as risk-reducing if it qualifies as a hedging contract pursuant to International Financial Reporting Standards adopted in accordance with article 3 of Regulation (EC) No 1606/2002 of the European Parliament and Council.

In the FCA's view, non-financial entity means the same thing as it does in Commission Delegated Regulation No X/X (regulatory technical standards for the application of position limits to commodity derivatives).

MiFID says that persons exempt under the commodities exemption described in the answer to Q44 are not required to meet the conditions laid down in the own account exemption described in this answer in order to be exempt. In the FCA's view that does not mean that you can do business of the type covered by the article 2.1(d) exemption without meeting the exemption conditions described in this answer just because you qualify for the commodities exemption. Recital 22 to MiFID confirms that the two exemptions apply cumulatively. Another reason for this conclusion is that articles 2.1(d) and (j) apply to different asset classes and there does not seem to be any reason in MiFID why exemption under article 2.1(j) should be relevant to the asset classes in article 2.1(d).

See the answer to Q46 for more information about combining this exemption with other exemptions, particularly the exemption for commodity derivatives business.

...

Employee share and company pension schemes

**Q42. Is there an exemption relating to employee share schemes and company pension schemes?**

...

This exemption can also be combined with the "group exemption" in article 2.1(b) of MiFID, by virtue of article 2.1(f) (g) of MiFID. ~~In our view, it may also be combined with the exemption in article 2.1(i) MiFID if a firm is dealing on own account in financial instruments as an ancillary activity to its main business, or, as the case may be, the main business of its group.~~ See the answer to Q46 for more about combining exemptions.

...

Exemption for commodity derivatives business

**Q44. Who can rely on the exemption in article 2.1(†) (j)?**

You may be able to rely on the exemption if:

- you deal on own account in ~~MiFID financial instruments~~ commodity derivatives or emission allowances or derivatives thereof; or
- provide other investment services in commodity derivatives or ~~C10 derivative contracts~~ emission allowances or derivatives thereof to clients or suppliers of your main business (or if you are part of a group, the group's main business); or
- both.

This exemption can include someone dealing on own account as a market maker.

If you deal on own account when executing client orders you can only meet the exemption condition if the client is a client or supplier of your group's main business.

The article 2.1(j) exemption does not apply to you if you apply a high frequency algorithmic trading technique.

~~However, the~~ The exemption will only apply if what you do is ancillary to your main business (see Q45 for more about this).

~~and that~~ The exemption is not available if your group's main business is any of the following:

- ~~neither~~ the provision of investment services ~~nor ; or~~
- the provision of banking services; or
- acting as a market maker in relation to commodity derivatives. ~~If you are part of a group, what you do must be ancillary to the main business of your group whose main business is neither the provision of investment services nor banking services.~~

~~In our view, a firm which is part of a group whose main business is not investment or banking services and which provides, for example, as a stand alone business, investment services in commodity derivatives or C10 contracts for its own clients (who are not clients of the group's main business), is likely to fall outside the scope of the article 2.1(i) exemption.~~

When considering what is a firm's or group's 'main business' for the purpose of the requirement that your main business should not be investment services, banking services or commodity derivatives market making, in our view various factors are likely to be relevant including turnover, profit, capital employed, numbers of employees and time spent by employees. These factors should then be considered in the round in deciding whether any one operation or business line



amounts to a firm's or your group's main business. In our view, a similar approach can be applied when determining a firm's 'main business' for the purposes of article 2.1(k) (see Q46).

The main business test in the previous paragraph is not directly related to the test for deciding whether your commodities business is ancillary to your main business (the ancillary test is described in the answer to Q45). This is because the ancillary business test compares the size of your commodities business with the rest of your business but is not designed to identify what your main business is if your non-commodities business is made up of a number of different business lines.

It is a condition of this exemption that you:

- should notify annually the relevant competent authority that you make use of this exemption; and
- upon request, report to the competent authority the basis on which you consider that the requirement for the commodities business to be ancillary is met.

If your Home State would be the United Kingdom if MiFID applied, the FCA is the relevant competent authority for these purposes.

If you carry out some occasional commodity derivatives activities but would find the annual notification obligation described above too burdensome you may not need to rely on this exemption. See the answer to Q7 (We provide investment services to our clients. How do we know whether we are an investment firm for the purposes of article 4.1(1) MiFID?) for more on this.

There is no requirement in the exemption that the person relying on it cannot carry on an activity covered by one of the other exemptions. In particular, this exemption can be combined with the exemption for own account transactions described in the answer to Q40 (see recital 22 to MiFID). For more on combining exemptions, please see the answer to Q46.

### **Q45. What is an ancillary activity for these purposes?**

The meaning of 'ancillary' is potentially subject to further European Commission legislation pursuant to article 2.3 MiFID. For an activity to be 'ancillary' for these purposes, in our view, it must at least be both directly related and subordinate to the main business of the group. Where, for example, a commodity producer buys or sells commodity derivatives for the purposes of limiting an identifiable risk of its main business, for instance in circumstances where the risk management exclusion in article 19 of the Regulated Activities Order would apply, in our view this would qualify as ancillary for the purposes of this exemption. On the other hand, where a commodity producer deals on own account for speculative purposes, it is unlikely that this would be ancillary to the main business in the case of article 2.1(i) MiFID. This activity may fall, however, within the article 2.1(k) MiFID exemption (see Q46) defined in RTS 21.

This answer does not give a full summary as the definition is too detailed for PERG. Instead this answer summarises the broad approach of the Regulation.

There are two tests. The exemption only applies if you meet both tests. Both are based on the trading activities of your group in the EEA.

The first test looks at the size of your trading activities in various asset classes. For each class, this is calculated by comparing the group's trading activities in that class with the total trading activities for that class.

The asset classes are made up of emission allowances and various types of commodity derivatives. The emission allowances asset class includes emission allowances to which the exemption for emission allowances in article 2.1(e) (see the table in the answer to Q35A) applies and any bidding under the auction regulation.

If the group's trading activity falls below the maximum amount set for each class, your group meets the first test. If your group's trading activities exceed the maximum amount for any class, your group fails the first test and the exemption is not available. There is a different maximum amount for each class.

Certain privileged transactions are excluded from the calculation:

- intra-group transactions that serve group-wide liquidity or risk management purposes;
- transactions in derivatives that reduce risks directly relating to commercial activity or treasury financing activity in accordance with criteria set out in the Commission Delegated Regulation;
- transactions in commodity derivatives and emission allowances entered into to fulfil obligations to provide liquidity on a trading venue, where such obligations are required by:
  - regulatory authorities in accordance with EEA law;
  - national laws, regulations and administrative provisions; or
  - trading venues; and
- transactions executed by a group member authorised under MiFID or the CRD.

The second test compares:

- the group's trading activities in all the commodity derivative and emission allowance classes in the first test; with
- the group's trading activities in all commodity derivatives, emission allowances and derivatives of emission allowances.

Privileged transactions (as defined for the purposes of the first test) are:

- excluded from the first bullet point;
- included in the second bullet point, except for transactions executed by a group member authorised under MiFID or the CRD, which are excluded.

Activities to which the exemption in article 2.1(e) (emissions trading scheme) applies and any bidding activities under the auction regulation are included in the second test. Generally the second test requires the trading activities in the first bullet point to be 10% or less of those in the second.

The group may exceed the 10% threshold if the size of the trading activity for each of the asset classes in the first test accounts for less than a specified percentage of the threshold for that class set by the first test.

The calculation is undertaken annually on the basis of an average of the trading activities carried out in the three annual calculation periods preceding the date of calculation. Each calculation period starts on 1 July and ends on 30 June of the following year.

*[Note: The FCA may consult again on this guidance about the meaning of ancillary activities once the Commission Delegated Regulation is finalised]*

**~~Q46. Our main business is producing commodities and we buy and sell commodity derivatives. We are a member of a non-financial services group. Are we exempt from MiFID Is it possible to combine article 2 exemptions?~~**

~~Yes. You will be exempt under article 2.1(k) MiFID because you are a person:~~

- ~~whose main business consists of dealing on own account in commodities and/or commodity derivatives, and~~
- ~~who is not part of a group whose main business is the provision of other investment services or banking services.~~

~~The question of what is your main business for the purposes of the first bullet point above is determined on an entity basis and not on a group basis (which is different from the approach taken in article 2.1(i) MiFID). You should also note that the article 2.1(k) MiFID exemption refers to commodities and/or commodity derivatives but not C10 derivatives.~~

~~Recital 22 of the MiFID Regulation indicates that the exemptions in article 2.1(i) and (k) MiFID could be expected to exclude significant numbers of commercial producers and consumers of energy and other commodities, including energy suppliers and commodity merchants.~~

Various other answers to questions in this section deal with certain detailed combinations of exemptions:

- Q42 deals with employee share schemes and company pension schemes.

- It is possible to combine the exemption for own account dealing in article 2.1(d) and the exemption for commodity derivatives in article 2.1(j). The answer to Q40 deals with the treatment of the commodity derivatives business of a firm relying on article 2.1(d). The answer to Q44 deals with the treatment of business within article 2.1(d) for a firm relying on the commodities derivatives exemption in article 2.1(j).

In certain cases a firm will not need to combine exemptions. For example an insurer relying on the exemption described in the answer to Q36 (We are an insurer. Does MiFID apply to us?) does not need to rely on any other exemption.

The answer to this question (Q46) is about whether there is a more general principle that article 2 exemptions can be combined.

There is an argument that the drafting of some of the exemptions does not allow this approach. For example, the group exemption (see the answer to Q37) says that the exemption is available to persons providing investment services exclusively for their fellow group members. However in the FCA's view it is generally possible to combine article 2 exemptions. Recital 22 to MiFID says that exemptions apply cumulatively and that the ability to combine the exemptions in articles 2.1(d) (own account dealing) and 2.1(j) (commodity derivatives) is just an example of this principle. This is consistent with the point that there is no reason apparent from MiFID why combining exemptions should not be allowed.

Where an exemption is only available if the person only carries on a limited range of investment services or activities (as is the case for example with the group exemption) it can be argued that this restriction does not cover a service or activity which is covered by another exemption. This is on the basis that an exempt activity is not an investment service or activity for these purposes. The section of the European Commission's website "Your Questions on Legislation" dealing with MiFID 1 takes this approach.

Treating an exempt activity as not being a MiFID investment service or activity in this way only applies for the purpose of article 2 of MiFID, meaning that it is only relevant for deciding whether a person is a MiFID investment firm.

#### **Q46A. Is it possible to combine the article 2 and article 3 exemptions?**

The FCA does not believe that it is generally possible to combine the exemptions in article 2 with the exemption in article 3. However in the FCA's view, a firm that relies on the article 2(1)(i) exemption (see Q43) can combine this with article 3 in relation to business falling outside the article 2(1)(i) exemption.

If however you are subject to UCITS Directive or the AIFMD you may be restricted in your ability to carry out all the activities within the article 3 exemption.

...

...

## 13 Annex 1G ...

[Delete: Flow chart 2 (Am I exempt under article 2 MiFID?)]

## 13 Annex 2G ...

...

**Table 2 - MiFID financial instruments and the Part 4A permission regime**

MiFID financial instrument	Part 4A permission category	Commentary
C1- Transferable securities	<p>...</p> <p>contract for differences (excluding a spread bet and a rolling spot forex contract and a binary bet)</p> <p>...</p>	<p><del>Transferable securities are securities negotiable on the capital market excluding instruments of payment and include:</del></p> <p><del>(a) shares in companies;</del></p> <p><del>(b) bonds;</del></p> <p><del>(c) depositary receipts;</del></p> <p><del>(d) warrants; and</del></p> <p><del>(e) miscellaneous securitised derivatives.</del></p> <p><del>Transferable securities also include various categories of derivatives in the permission regime (see column 2 headed Part 4A permission category).</del></p> <p>The permission investment categories <u>above in column 2</u>; however, are wider than the MiFID definition of transferable securities, as they comprise both securitised and non-securitised instruments. Firms with permissions containing these investment categories will fall outside the article 3 MiFID exemption as transposed in domestic legislation, where they provide investment services in relation to financial instruments which</p>

		are non-securitised investments (for example, OTC derivatives concluded by a confirmation under an ISDA master agreement). ...
...		
C4- Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, emission allowances or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash	... contract for differences (excluding a spread bet <del>and</del> , a rolling spot forex contract and a <u>binary bet</u> ) spread bet <u>binary bet</u>	... For further guidance, see <del>Q30</del> and <del>Q32</del> <u>Q31A to Q31O</u> . ...
C5- Options, futures, swaps, <del>forward rate agreements</del> <u>forwards</u> and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event)	... contract for differences (excluding a spread bet <del>and</del> , a rolling spot forex contract and a <u>binary bet</u> ) <u>binary bet</u>	... For further guidance see <del>Q32</del> and <del>Q33</del> <u>Q33A</u> .
C6- Options, futures, swaps, and any other derivative contracts relating to commodities that can be physically settled provided that they are traded on a regulated market <del>and/or</del> , an MTF or an <u>OTF</u>	... contract for differences (excluding a spread bet <del>and</del> , a rolling spot forex contract and a <u>binary bet</u> )	... For further guidance see <del>Q32</del> and <del>Q33</del> <u>Q33B</u> .

	<u>binary bet</u>	
<p>C7- Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C.6 <del>and not being</del>. <u>This category does not include spot contracts or contracts that meet certain conditions that are designed to exclude contracts for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls</u></p>	<p>...</p> <p>contract for differences (excluding a spread bet <del>and</del> a rolling spot forex contract <u>and a binary bet</u>)</p> <p><u>binary bet</u></p>	<p><del>C7 is supplemented by Level 2 measures (see article 38 of the MiFID Regulation).</del></p> <p>For further guidance see <del>Q32</del> <u>and Q33 Q33C</u>.</p>
<p>C8- Derivative instruments for the transfer of credit risk</p>	<p>...</p> <p>contract for differences (excluding a spread bet <del>and</del> a rolling spot forex contract <u>and a binary bet</u>)</p> <p>...</p>	<p>...</p>
<p>C9- Financial contracts for differences</p>	<p>contract for differences (excluding a spread bet <del>and</del> a rolling spot forex contract <u>and a binary bet</u>)</p> <p>...</p>	<p>...</p>

<p>C10- Options, futures, swaps, forward rate agreements and any other derivative contracts relating to <del>climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics</del> <u>various specified underlyings</u> that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), <del>as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognised clearing houses or are subject to regular margin calls</del> <u>This category does not include contracts that meet certain conditions designed to exclude non-financial derivative instruments.</u></p>	<p>...</p> <p>contract for differences (excluding a spread bet <u>and</u>, a rolling spot forex contract <u>and a binary bet</u>)</p> <p>spread bet</p> <p><del>emissions auction product</del></p> <p><u>binary bet</u></p>	<p><del>€10 is supplemented by Level 2 measures (see articles 38 and 39 of the MiFID Regulation) and comprises miscellaneous derivatives.</del></p> <p>For further guidance see Q34.</p>
<p>...</p>		



---

## Appendix 2

# New Form A to be included in SUP 10A Annex 4D

1. This appendix comprises the following new form to be included in SUP 10A Annex 4D. The FCA is proposing to issue the new form under our powers of direction under section 55U and section 60 of the Financial Services and Markets Act 2000 (the Act).
2. New Long Form A – UK and Overseas Firms (not Incoming EEA) for MiFID 2 authorisation applications”

Application number  
(for FCA use only)

The FCA has produced notes which will assist both the applicant and the candidate in answering the questions in this form. Please read these notes, which are available on the FCA website at:

- <https://www.handbook.fca.org.uk/handbook/SUP/10A/Annex4.html>

Both the applicant and the candidate will be treated by the FCA as having taken these notes into consideration when completing their answers to the questions in this form.

## Long Form A – UK and Overseas Firms (not Incoming EEA) for MiFID 2 authorisation applications\*

### Application to perform controlled functions under the approved persons regime

FCA Handbook Reference: SUP 10A Annex 4D

[date]

Name of *candidate*<sup>†</sup>  
(to be completed by applicant firm)

Name of *firm*<sup>†</sup>  
(as entered in 2.01)

*Firm* reference number<sup>†</sup>  
(as entered in 2.02)

Financial Conduct Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS  
United Kingdom  
Telephone +44 (0) 300 500 0597  
Facsimile +44 (0) 207 066 0017  
E-mail [iva@fca.org.uk](mailto:iva@fca.org.uk)  
Website <http://www.fca.org.uk>

Registered as a Limited Company in England and Wales No 1920623.  
Registered Office as above.

\*This Form should only be used when a firm applies for permission in accordance with Commission Delegated Regulation (EU) [XXX] of 14.7.2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards on information and requirements for the authorisation of investment firms)

† The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7 Long Form A – UK and Overseas

Application to perform controlled functions under the approved persons regime  
Version 1

1.01	a	<i>Candidate</i> Individual Reference Number (IRN) †	
	b	OR name of previous regulatory body †	
	c	AND previous reference number (if applicable) †	
1.02		Title (e.g. Mr, Mrs, Ms, etc) †	
1.03		Surname †	
1.04		ALL forenames †	
1.05		Name commonly known by †	
1.06		Date of birth (dd/mm/yyyy) †	
1.07		National Insurance number †	
1.08		Previous name †	
1.09		Date of name change †	
1.10	a	Nationality †	
	b	Passport number (if National Insurance number not available) †	
1.11		Place of birth †	
1.12		Contact telephone number	



I have supplied further information related to this page in Section 6 †

YES

NO

† The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7 Long Form A – UK and Overseas Application to perform controlled functions under the approved persons regime Version 1

1.13 a Private address<sup>†</sup>

[Redacted address field]

b Postcode<sup>†</sup>

c Dates resident at this address (mm/yyyy)<sup>†</sup> From [Redacted] To PRESENT

(If address has changed in the last three years, please provide addresses for the previous three years.)

1.14 a Previous address 1<sup>†</sup>

[Redacted address field]

b Postcode<sup>†</sup>

c Dates resident at this address (mm/yyyy)<sup>†</sup> From [Redacted] To [Redacted]

1.15 a Previous address 2<sup>†</sup>

[Redacted address field]

b Postcode<sup>†</sup>

c Dates resident at this address (mm/yyyy)<sup>†</sup> From [Redacted] To [Redacted]



I have supplied further information related to this page in Section 6<sup>†</sup>

YES

NO

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7 Long Form A – UK and Overseas Application to perform controlled functions under the approved persons regime Version 1

2.01	Name of <i>firm</i> making the application	
2.02	Firm Reference Number (FRN)	
2.03 a	Who should the <i>FCA</i> contact at the <i>firm</i> in relation to this application?	
b	Position	
c	Telephone	
d	Fax	
e	E-mail	



I have supplied further information related to this page in Section 6<sup>†</sup>

YES

NO

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7 Long Form A – UK and Overseas Application to perform controlled functions under the approved persons regime Version 1

**3.01** Nature of the arrangement between the candidate and the applicant.

<i>a</i>	Employee	<input type="checkbox"/>
<i>b</i>	Group employee	<input type="checkbox"/>
	Name of group	
<i>c</i>	Contract for services	<input type="checkbox"/>
<i>d</i>	Partner/Sole trader	<input type="checkbox"/>
<i>e</i>	Appointed representative/tied agent – customer function	<input type="checkbox"/>
	AR firm name and reference number	
<i>f</i>	Appointed representative/tied agent – governing function	<input type="checkbox"/>
	AR firm name and reference number	
<i>g</i>	Other	<input type="checkbox"/>
	Give details	

**3.02** For applications from a single firm, please tick the boxes that correspond to the controlled functions to be performed. If the controlled functions are to be performed for more than one firm, please go to question **3.05**

<b>a</b>	<b>Significant influence functions</b>	<table border="0"> <tr><td>CF 1</td><td>Director function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 2</td><td>Non-executive director function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 3</td><td>Chief executive function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 4</td><td>Partner function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 5</td><td>Director of an unincorporated association function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 6</td><td>Small friendly society function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 8</td><td>Apportionment and oversight function <small>(this function is not applicable to all firms please refer to Notes for Completing Form A)</small></td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 10</td><td>Compliance oversight function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 10a</td><td>CASS operational oversight function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 11</td><td>Money laundering reporting function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 12</td><td>Actuarial function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 12A</td><td>With-profits actuary function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 12B</td><td>Lloyd's Actuary function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 28</td><td>System and controls function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 29</td><td>Significant management function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 40</td><td>Benchmark submission function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> <tr><td>CF 50</td><td>Benchmark administration function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> </table>	CF 1	Director function	<input type="checkbox"/>	CF 2	Non-executive director function	<input type="checkbox"/>	CF 3	Chief executive function	<input type="checkbox"/>	CF 4	Partner function	<input type="checkbox"/>	CF 5	Director of an unincorporated association function	<input type="checkbox"/>	CF 6	Small friendly society function	<input type="checkbox"/>	CF 8	Apportionment and oversight function <small>(this function is not applicable to all firms please refer to Notes for Completing Form A)</small>	<input type="checkbox"/>	CF 10	Compliance oversight function	<input type="checkbox"/>	CF 10a	CASS operational oversight function	<input type="checkbox"/>	CF 11	Money laundering reporting function	<input type="checkbox"/>	CF 12	Actuarial function	<input type="checkbox"/>	CF 12A	With-profits actuary function	<input type="checkbox"/>	CF 12B	Lloyd's Actuary function	<input type="checkbox"/>	CF 28	System and controls function	<input type="checkbox"/>	CF 29	Significant management function	<input type="checkbox"/>	CF 40	Benchmark submission function	<input type="checkbox"/>	CF 50	Benchmark administration function	<input type="checkbox"/>
CF 1	Director function	<input type="checkbox"/>																																																			
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CF 50	Benchmark administration function	<input type="checkbox"/>																																																			
<b>b</b>	<b>Customer function</b>	<table border="0"> <tr><td>CF 30</td><td>Customer function</td><td style="text-align: right;"><input type="checkbox"/></td></tr> </table>	CF 30	Customer function	<input type="checkbox"/>																																																
CF 30	Customer function	<input type="checkbox"/>																																																			

**3.03** Effective date of controlled functions indicated above<sup>†</sup>

**3.04** Job title<sup>†</sup>  
Please refer to notes on the requirements for submitting a CV

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7 Long Form A – UK and Overseas Application to perform controlled functions under the approved persons regime Version 1

**Insurance mediation**

Will the candidate be responsible for Insurance mediation at the firm?

(Note: Yes can only be selected if the individual is applying for (CF1, 3-8 or 29)

YES  NO

**Mortgage Credit Directive**

Will the candidate be responsible for Mortgage Credit Directive Intermediation at the firm?

(Note: Yes can only be selected if the individual is applying for (CF1, 3-8 or 29)

YES  NO



I have supplied further information related to this page in Section 6<sup>†</sup>

YES  NO

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7 Long Form A – UK and Overseas Application to perform controlled functions under the approved persons regime Version 1

**3.05 Complete this section only if the application is on behalf of more than one firm.**

List all *firms* within the *group* (including the *firm* entered in 2.01) for which the *candidate* requires approval and the requested *controlled function* for that *firm*.<sup>†</sup>

	<b>Firm Reference Number</b>	<b>Name of firm</b>	<b>Controlled function</b>	<b>Job title</b>	<b>Effective date</b>
<b>a</b>					
<b>b</b>					
<b>c</b>					
<b>d</b>					
<b>e</b>					



I have supplied further information related to this page in Section 6<sup>†</sup>

YES

NO

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7  
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## 4.01 Employment details (1) †

N.B.: ALL gaps must be accounted for

<b>a</b>	Period (mm/yyyy)	From		To	
<b>b</b>	Nature of employment	<b>a</b>	Employed		<input type="checkbox"/>
		<b>b</b>	Self-employed		<input type="checkbox"/>
		<b>c</b>	Not employed		<input type="checkbox"/>
		<b>d</b>	Full-time education		<input type="checkbox"/>
	If c or d is ticked, please give details				
<b>c</b>	Name of employer				
<b>d</b>	Nature of business				
<b>e</b>	Previous / other names of employer				
<b>f</b>	Last known address of employer				
<b>g</b>	Is/was employer regulated by a regulatory body?	YES	<input type="checkbox"/>	NO	<input type="checkbox"/>
				Name of regulatory body	
<b>h</b>	Is/was employer an <i>appointed representative/tied agent</i> ?	YES	<input type="checkbox"/>	NO	<input type="checkbox"/>
				If yes, of which <i>firm</i> ?	
<b>i</b>	Position held				
<b>j</b>	Responsibilities				
<b>k</b>	Reason for leaving:	<b>a</b>	Resignation		<input type="checkbox"/>
		<b>b</b>	Redundancy		<input type="checkbox"/>
		<b>c</b>	Retirement		<input type="checkbox"/>
		<b>d</b>	Termination/dismissal		<input type="checkbox"/>
		<b>e</b>	End of contract		<input type="checkbox"/>
		<b>f</b>	Other		<input type="checkbox"/>
	Specify				

† The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7  
 Long Form A – UK and Overseas  
 Application to perform controlled functions under the approved persons regime  
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**4.02 Employment details (2) †**

<b>a</b>	Period (mm/yyyy)	From	<input type="text"/>	To	<input type="text"/>
<b>b</b>	Nature of employment	<i>a</i>	Employed	<input type="checkbox"/>	
		<i>b</i>	Self-employed	<input type="checkbox"/>	
		<i>c</i>	Not employed	<input type="checkbox"/>	
		<i>d</i>	Full-time education	<input type="checkbox"/>	
	If <i>c</i> or <i>d</i> is ticked, please give details				
<b>c</b>	Name of employer	<input type="text"/>			
<b>d</b>	Nature of business	<input type="text"/>			
<b>e</b>	Previous / other names of employer	<input type="text"/>			
<b>f</b>	Last known address of employer	<input type="text"/>			
<b>g</b>	Is/was employer regulated by a regulatory body?	YES <input type="checkbox"/>	NO <input type="checkbox"/>	Name of regulatory body	
				<input type="text"/>	
<b>h</b>	Is/was employer an <i>appointed representative/tied agent</i> ?	YES <input type="checkbox"/>	NO <input type="checkbox"/>	If yes, of which <i>firm</i> ?	
				<input type="text"/>	
<b>i</b>	Position held	<input type="text"/>			
<b>j</b>	Responsibilities	<input type="text"/>			
<b>k</b>	Reason for leaving:	<i>a</i>	Resignation	<input type="checkbox"/>	
		<i>b</i>	Redundancy	<input type="checkbox"/>	
		<i>c</i>	Retirement	<input type="checkbox"/>	
		<i>d</i>	Termination/dismissal	<input type="checkbox"/>	
		<i>e</i>	End of contract	<input type="checkbox"/>	
		<i>f</i>	Other	<input type="checkbox"/>	
	Specify	<input type="text"/>			



I have supplied further information related to this page in Section 6† YES  NO

† The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7  
 Long Form A – UK and Overseas  
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**5.01 Criminal Proceedings**

When answering the questions in this section the candidate should include matters whether in the UK or overseas. By virtue of the Rehabilitation of Offenders Act 1974 (Exceptions) Order 1975, if the candidate is subject to the law of England and Wales, the candidate must disclose spent convictions and cautions (other than a protected conviction or caution). By virtue of the Rehabilitation of Offenders Act 1974 (Exclusions and Exceptions) (Scotland) Order 2013 and the Rehabilitation of Offenders (Exceptions) Order (Northern Ireland) 1979, if the candidate is subject to the law of Scotland or Northern Ireland, you must disclose spent convictions (other than a protected conviction).

For the avoidance of doubt, references to the legislation above are references to the legislation as amended.

- 5.01.1a** Has the *candidate* **ever** been convicted of any criminal offence (whether spent or not and whether or not in the *United Kingdom*):
- i. involving fraud, theft, false accounting, offences against the administration of public justice (such as perjury, perverting the course of justice and intimidation of witnesses or jurors), serious tax offences or other dishonesty: or
  - ii. relating to *companies, building societies, industrial and provident societies, credit unions, friendly societies, insurance, banking or other financial services, insolvency, consumer credit or consumer protection, money laundering, market manipulations or insider dealing?*

If the answer to the question above is “yes”, please provide an official certificate of conviction or equivalent document if and so far as it is available from the UK or, where applicable, another country. Please attach a copy of this form as an Additional Supporting Document.

YES  NO

- b** Is the *candidate* currently the subject of any criminal proceedings, whether in the UK or elsewhere?

YES  NO

- c** Has the *candidate* **ever** been given a caution in relation to any criminal offence?

YES  NO

- 5.01.2** Has the *candidate* any convictions for any offences other than those in 5.01.1 above (excluding traffic offences that did not result in a ban from driving or did not involve driving without insurance)?

YES  NO

- 5.01.3** Is the *candidate* the subject of any ongoing criminal investigation?

YES  NO

- 5.01.4** Has the *candidate* been ordered to produce documents pursuant to any ongoing criminal investigation or been the subject of a search (with or without a warrant) pursuant to any ongoing criminal investigation?

YES  NO

In answering question 5.01.4, you should include all matters even where the candidate was not the subject of the investigation.



I have supplied further information related to this page in Section 6<sup>†</sup>

YES  NO

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7 Long Form A – UK and Overseas Application to perform controlled functions under the approved persons regime Version 1

**5.01.5** Has any firm at which the *candidate* holds or has held a position of influence ever:

- |          |  |                              |                             |
|----------|--|------------------------------|-----------------------------|
| <b>a</b> | Been convicted of any criminal offence?<br>(Please check the guidance notes for the meaning of 'position of influence' in the context of the questions in this part of the form.)  | YES <input type="checkbox"/> | NO <input type="checkbox"/> |
| <b>b</b> | Been summonsed, charged with or otherwise investigated or prosecuted for any criminal offence?   | YES <input type="checkbox"/> | NO <input type="checkbox"/> |
| <b>c</b> | Been the subject of any criminal proceeding which has not resulted in a conviction?  | YES <input type="checkbox"/> | NO <input type="checkbox"/> |
| <b>d</b> | Been ordered to produce documents in relation to any criminal investigation or been the subject of a search (with or without a warrant) in relation to any criminal investigation? | YES <input type="checkbox"/> | NO <input type="checkbox"/> |

In answering question 5.01.5, you should include all matters even when the summons, charge, prosecution or investigation did not result in a conviction, and, in respect of 5.01.5d, even where the firm was not the subject of the investigation. However, firms are not required to disclose details of any specific individuals who were subject to historic (as opposed to ongoing) criminal investigations, prosecutions, summons or other historic criminal proceedings.



I have supplied further information related to this page in Section 6<sup>†</sup> YES  NO

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7  
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## 5.02 Civil Proceedings

**5.02.1** Has the candidate, **ever** been the subject of a judgment debt or award against the candidate?

YES  NO

Please give a full explanation of the events in questions, ensuring that it adheres to the Disclosure Note at the beginning of this form.

You should include all County Court Judgment(s) (CCJs) made against the candidate, whether satisfied or not); and

i) the sum and date of all judgment debts, awards or CCJs (whether satisfied or not); and

ii) the total number of all judgment debts, awards or CCJs ordered.

**5.02.2** Has the *candidate* ever been party to any civil proceedings which resulted in any order against the candidate (other than a judgment debt or award referred to in 5.02.1 above)? (You should include, for example, injunctions and employment tribunal proceedings.)

YES  NO

**5.02.3** Is the candidate aware of:

**a** Any proceedings that have begun or anyone's intention to begin proceedings against the candidate, for a CCJ or another judgment debt?

YES  NO

**b** More than one set of proceedings, or anyone's intention to begin more than one set of proceedings, that may lead to a CCJ or other judgment debt?

YES  NO

**c** Anybody's intention to claim more than £1,000 of CCJs or judgment debts in total from the candidate?

YES  NO

**5.02.4** Does the candidate have any **current** judgment debts (including CCJs) made under a court order still outstanding, whether in full or in part?

YES  NO

**5.02.5** Has the *candidate* **ever** failed to satisfy any such judgment debts (including CCJs) made under a court order still outstanding, whether in full or part, within one year of the order being made?

YES  NO



I have supplied further information related to this page in Section 6<sup>†</sup>

YES  NO

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7 Long Form A – UK and Overseas Application to perform controlled functions under the approved persons regime Version 1

**5.02.6** Has the *candidate* ever:

**a** Filed for the candidate's own bankruptcy or had a bankruptcy petition served on the candidate? YES  NO

**b** Been adjudged bankrupt? YES  NO

**c** Been the subject of a bankruptcy restrictions order (including an interim bankruptcy restrictions order) or offered a bankruptcy restrictions undertaking? YES  NO

**d** Made any arrangements with the candidate's creditors, for example a deed of arrangement or an individual voluntary arrangement (or in Scotland a trust deed)? YES  NO

**e** Had assets sequestrated? YES  NO

**f** Been involved in any proceedings relating to the above matters even if such proceedings did not result in the making of any kind of order against the candidate or result in any kind of agreement with the candidate? YES  NO

**5.02.7** Does the *candidate*, or any undertaking under their management, have any outstanding financial obligations arising from *regulated activities*, which have been carried out in the past (whether or not in the UK or overseas)? YES  NO

**5.02.8** Has the *candidate* ever been adjudged by a court or tribunal (whether criminal, civil or administrative) for any fraud, misfeasance, negligence, wrongful trading or other misconduct? YES  NO

**5.02.9** Is the *candidate* currently:

**a** Party to any civil proceedings (including those covered in 5.02.7 above)? YES  NO

**b** Aware of anybody's intention to begin civil proceedings against the candidate? (You should include any ongoing disputes whether or not such dispute is likely to result in any order against the candidate.) YES  NO

**5.02.10** Has any firm at which the *candidate* holds or has held a position of influence ever been:

**a** Adjudged by a court civilly liable for any fraud, misfeasance, wrongful trading or other misconduct? YES  NO

**b** The subject of a judgment debt or award against the firm? (You should include all CCJs made against the firm, whether satisfied or not.) YES  NO

**c** Party to any other civil proceedings which resulted in an order against the firm other than in relation to matters covered in 5.02.10a and 5.02.10b above? YES  NO



I have supplied further information related to this page in Section 6<sup>†</sup> YES  NO

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7 Long Form A – UK and Overseas Application to perform controlled functions under the approved persons regime Version 1

**5.02.11** Is any firm at which the *candidate* currently holds or has held, within the last 12 months from the date of the submission of this form, a position of influence currently:

**a** A party to civil proceedings?

YES  NO

**b** Aware of anyone's intention to begin civil proceedings against them?

YES  NO

**5.02.12** Has any company, partnership or unincorporated association of which the *candidate* is or has been a controller, director, senior manager, partner or company secretary, in the United Kingdom or elsewhere, at any time during their involvement, or within one year of such an involvement, been put into liquidation, wound up, ceased trading, had a receiver or administrator appointed or entered into any voluntary arrangement with its creditors?

YES  NO



I have supplied further information related to this page in Section 6<sup>†</sup>

YES  NO

### 5.03 Business and Employment Matters

5.03.1 Has the *candidate* ever been:

a Disqualified from acting as a director or similar position (one where the candidate acts in a management capacity or conducts the affairs of any company, partnership or unincorporated association)? YES  NO

b The subject of any proceedings of a disciplinary nature (whether or not the proceedings resulted in any finding against the *candidate*)? YES  NO

c The subject of any investigation which has led or might lead to disciplinary proceedings? YES  NO

d Notified of any potential proceedings of a disciplinary nature against the candidate? YES  NO

e The subject of an investigation into allegations of misconduct or malpractice in connection with any business activity? (This question covers internal investigation by an authorised firm, as well as investigation by a regulatory body, at any time.) YES  NO

5.03.2 Has the *candidate* ever been refused entry to, or been dismissed, suspended or requested to resign from, any professional, vocation, office or employment, or from any fiduciary office or position of trust whether or not remunerated? YES  NO

5.03.3 Does the *candidate* have any material written complaints made against the candidate by the candidate's clients or former clients in the last five years which the candidate has accepted, or which are awaiting determination, or have been upheld – by an ombudsman or complaints scheme? YES  NO



I have supplied further information related to this page in Section 6<sup>†</sup> YES  NO

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7  
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## 5.04 Regulatory Matters

**5.04.1** In relation to activities regulated by the FCA or any other regulatory body (see section 5 guidance notes), has:

- The *candidate*, or
- Any company, partnership or unincorporated associate of which the candidate is or has been a controller, director, senior manager, partner or company secretary, during the candidate's association with the entity and for a period of three years after the candidate ceased to be associated with it, ever:

<b>a</b>	Been refused, had revoked, restricted, been suspended from or terminated, any licence, authorisations, registration, notification, membership or any other permission granted by any such body?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
<b>b</b>	Been criticised, censured, disciplined, suspended, expelled, fined or been the subject of any other disciplinary or interventional action by any such body?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
<b>c</b>	Received a warning (whether public or private) that such disciplinary or interventional action may be taken against the candidate or the firm?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
<b>d</b>	Been the subject of an investigation by any regulatory body, whether or not such an investigation resulted in a finding against the candidate or the firm?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
<b>e</b>	Been required or requested to produce documents or any other information to any regulatory body in connection with such an investigation (whether against the firm or otherwise)?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
<b>f</b>	Been investigated or been involved in an investigation by an inspector appointed under companies or any other legislation, or required to produce documents to the Secretary of State, or any other authority, under any such legislation?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
<b>g</b>	Ceased operating or resigned whilst under investigation by any such body or been required to cease operating or resign by any regulatory body?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
<b>h</b>	Decided, after making an application for any licence, authorisation, registration, notification, membership or any permission granted by any such body, not to proceed with it?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
<b>i</b>	Been the subject of any civil action related to any regulated activity which has resulted in a finding by a court?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
<b>j</b>	Provided payment services or distributed or redeemed e-money on behalf of a regulated firm or itself under any contractual agreement where that agreement was terminated by the regulated firm?	YES <input type="checkbox"/>	NO <input type="checkbox"/>
<b>k</b>	Been convicted of any criminal offence, censured, disciplined or publicly criticised by any inquiry, by the Takeover Panel or any governmental or statutory authority or any other regulatory body (other than as indicated in this group of questions).	YES <input type="checkbox"/>	NO <input type="checkbox"/>



I have supplied further information related to this page in Section 6<sup>†</sup> YES  NO

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7 Long Form A – UK and Overseas Application to perform controlled functions under the approved persons regime Version 1

**5.04.2** In relation to activities regulated by the FCA or any other regulatory body, has the *candidate* or any firm at which the *candidate* holds or has held a position of influence at any time during and within one year of the candidate's association with the firm ever:

- |          |   |                              |                             |
|----------|---|------------------------------|-----------------------------|
| <b>a</b> | Been found to have carried on activities for which authorisation or registration by the FCA or any other regulatory body is required without the requisite authorisations?  | YES <input type="checkbox"/> | NO <input type="checkbox"/> |
| <b>b</b> | Been investigated for the possible carrying on of activities requiring authorisation or registration by the FCA or any other regulatory body without the requisite authorisation whether or not such investigation resulted in a finding against the candidate?                 | YES <input type="checkbox"/> | NO <input type="checkbox"/> |
| <b>c</b> | Been found to have performed a controlled function (or an equivalent function requiring approval by the FCA/PRA or any other regulatory body) without the requisite approval?   | YES <input type="checkbox"/> | NO <input type="checkbox"/> |
| <b>d</b> | Been investigated for the possible performance of a controlled function (or an equivalent function requiring approval by the FCA or any other regulatory body) without the requisite approval, whether or not such investigation resulted in a finding against the candidate?   | YES <input type="checkbox"/> | NO <input type="checkbox"/> |
| <b>e</b> | Been found to have failed to comply with an obligation under the Electronic Money Regulations 2011 or Payment Services Regulations 2009 to notify the FCA of the identity of a person acting in a position of influence over its electronic money or payment services business? | YES <input type="checkbox"/> | NO <input type="checkbox"/> |
| <b>f</b> | Been the subject of disqualification direction under section 59 of the Financial Services Act 1986 or a prohibition order under section 56 FSMA, or received a warning notice proposing that such a direction or order be made, or received a private warning?                  | YES <input type="checkbox"/> | NO <input type="checkbox"/> |



I have supplied further information related to this page in Section 6<sup>†</sup> YES  NO

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7  
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**5.05 Other Matters**

**5.05.1** Is the *candidate*, in the role to which the application relates, aware of any business interests, employment obligations, or any other circumstance which may conflict with the performance of the controlled functions for which approval is now being sought. Please include details of any financial or non-financial interests or relationships of the candidate and their close relatives to members of the management body and **key function holders** in the same institution, the parent institution and subsidiaries and shareholders? **For the purposes of this question management body<sup>†</sup> has the meaning in Directive 2014/65/EU.**

YES  NO

**5.05.2** Is the *candidate* or the *firm* aware of any other information relevant to this notification that we might reasonably expect from the *candidate*?

YES  NO



I have supplied further information related to this page in Section 6<sup>†</sup>

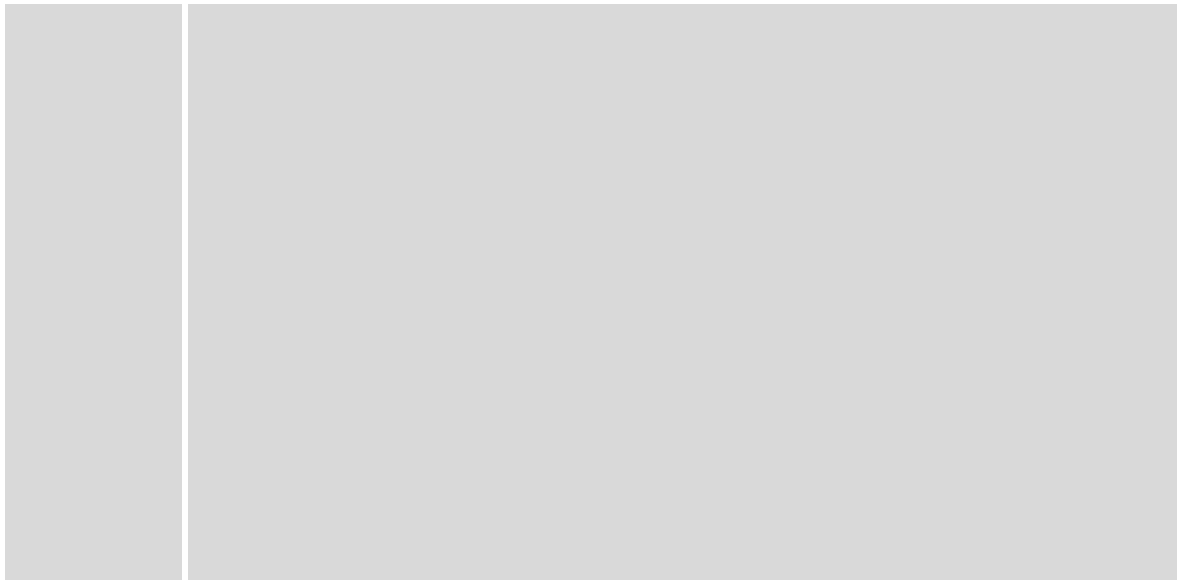
YES  NO

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7  
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- 6.01
- If there is any other information the *candidate* or the *firm* considers to be relevant to the application, it must be included here.
  - Please provide full details of:
    - why the candidate is competent and capable to carry out the controlled function(s) applied for;
    - why the appointment complements the firm's business strategy, activity and market in which it operates;
    - how the appointment was agreed including details of any discussions at governing body level (where applicable);
    - the minimum time that will be devoted to the performance of the person's functions within the firm (please provide an indication of the time spent per month and per annum);
    - the human and financial resources devoted to the induction and training of the candidate (please provide an indication of the time spent per annum);
    - details of any previous assessments of the candidate's fitness and propriety as a controller or director which have been undertaken by any other regulatory body (if known) (please include the date of the assessment, the name of the regulatory body and details of the outcome);
    - a copy of the *candidate's*:  
Curriculum Vitae (C.V.) including details of relevant education and professional training and professional experience.  
The candidate's C.V. should include the names of all organisations where the candidate has worked during the past ten years, details of the nature and duration of the functions performed at those organisations and details of any activities at those organisations which are related to the role for which is approval is being sought. The C.V. should also include details of all delegated powers and internal decision-making powers and details of the areas of operations for which the candidate was responsible whilst working at the organisations above. The information above does not need to be included in the C.V. if it has been provided in Section 4 of this form.
    - References in relation to the candidate's reputation and experience (including contact details of the referees).
  - Please also include here any additional information indicated in previous sections of the Form.
  - **Please include a list of all directorships currently or previously held by the *candidate* in the past 10 years (where *director* has the meaning given in the *Glossary*.)**
  - If there is insufficient space, please continue on a separate sheet of paper and clearly identify the section and question to which the additional information relates.
  - **Full details must be provided here if there were any issues that could affect the Fitness and Propriety of the individual that arose when leaving an employer listed in section 4 or if any question has been answered 'yes' in section 5.**

Question	Information

† The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7 Long Form A – UK and Overseas  
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**Declaration of *Candidate***

Knowingly or recklessly giving the *FCA* information which is false or misleading in a material particular may be a criminal offence (section 398 of the Financial Services and Markets Act 2000).

It should not be assumed that information is known to the *FCA* merely because it is in the public domain or has previously been disclosed to the *FCA* or another regulatory body. If there is any doubt about the relevance of information, it should be included.

For the purposes of complying with the Data Protection Act, the personal information provided in this Form will be used by the *FCA* to discharge its statutory functions under the Financial Services and Markets Act 2000 and other relevant legislation, and will not be disclosed for any other purpose without the permission of the applicant.

With reference to the above, the *FCA* may seek to verify the information given in this Form including answers pertaining to fitness and propriety. This may include a credit reference check.

In signing the form below:

**a) I authorise the *FCA* to make such enquiries and seek such further information as it thinks appropriate in the course of verifying the information given in this Form. Individual candidates may be required to apply to the Disclosure and Barring Service for a search to be made as to whether any criminal records are held in relation to them and to disclose the result of that search to us. I also understand that the results of these checks may be disclosed to the firm submitting this application.**

**b) I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to this Form.**

**c) I confirm that I understand the regulatory responsibilities of my proposed role as set out in the Statements of Principle and Code of Practice for Approved Persons (<https://www.handbook.fca.org.uk/handbook/APER>)**

Tick here to confirm you have read and understood this declaration:

7.01 *Candidate's* full name<sup>†</sup>

7.02 Signature\*

Date <sup>†</sup>

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in SUP 15.7 Long Form A – UK and Overseas Application to perform controlled functions under the approved persons regime Version 1

**Declaration of Firm**

Knowingly or recklessly giving the *FCA* information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). *SUP* 15.6.1R and *SUP* 15.6.4R require an *authorised person* to take reasonable steps to ensure the accuracy and completeness of information given to the *FCA* and to notify the *FCA* immediately if materially inaccurate information has been provided.

*APER* 4.4.7E provides that, where an *approved person* is responsible for reporting matters to the *FCA*, failure to inform the *FCA* of materially significant information of which he is aware is a breach of *Statement of Principle* 4. Contravention of these requirements may lead to disciplinary sanctions or other enforcement action by the *FCA*. It should not be assumed that information is known to the *FCA* merely because it is in the public domain or has previously been disclosed to the *FCA* or another regulatory body. If there is any doubt about the relevance of information, it should be included.

**In making this application the *firm* believes on the basis of due and diligent enquiry that the candidate is a fit and proper person to perform the controlled function(s) listed in section 3. The firm also believes, on the basis of due and diligent enquiry, that the candidate is competent to fulfil the duties required in the performance of such function(s).**

**In signing this form on behalf of the firm:**

- a) I confirm that the information in this Form is accurate and complete to the best of my knowledge and belief and that I have read the notes to this Form.
- b) I confirm that I have authority to make this application, and sign this Form, on behalf of each *firm* identified in section 3.05. I also confirm that a copy of this Form, as submitting to the *FCA*, will be sent to each of those *firms* at the same time as submitting the Form to the *FCA*.
- c) I confirm the candidate has been made aware of the regulatory responsibilities of the proposed role as set out in the Statements of Principle and Code of Practice for Approved Persons

(<https://www.handbook.fca.org.uk/handbook/APER>)

7.03	Name of the <i>firm</i> submitting the application <sup>†</sup>	
7.04	Name of <i>person</i> signing on behalf of the <i>firm</i> <sup>†</sup>	
7.05	Job title <sup>†</sup>	
7.06	Signature <sup>*</sup>	
	Date <sup>†</sup>	

<sup>†</sup> The above question(s) should be completed whether submission of this form is online or in one of the other ways set out in *SUP* 15.7  
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