

Consultation Paper

CP17/8***

Markets in Financial Instruments Directive II Implementation – Consultation Paper V (including changes to conduct rules for Occupational Pension Scheme firms)



March 2017

Contents

Abbreviations used in this paper	3
1 Overview	7
2 Specialist regimes – Occupational Pension Scheme (OPS) firms	10
3 Decision Procedure and Penalties and Penalties Manual (DEPP) and Enforcement Guide (EG)	22
4 Consequential changes to the Handbook and reporting financial instrument reference data and positions in commodity derivatives	27
Annexes	
1 List of questions	29
2 Cost benefit analysis	31
3 Compatibility statement	42
Appendix	
Draft Handbook text	44

We are asking for comments on this consultation paper (CP) by 23 June 2017 for chapter 2 and 12 May 2017 for chapters 3 and 4.

You can send them to us using the form on our website at:
www.fca.org.uk/your-fca/documents/consultation-papers/cp17-08-response-form.

Alternatively, you can send them in writing to:

MiFID Coordination
Markets Policy Department
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7066 9758
Email: cp17-08@fca.org.uk

We have developed the policy in this Consultation Paper in the context of the existing UK and EU regulatory framework. The Government has made clear that it will continue to implement and apply EU law until the UK has left the EU. We will keep the proposals under review to assess whether any amendments may be required in the event of changes in the UK regulatory framework in the future.

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.

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.

You can download this consultation paper from our website: www.fca.org.uk.

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please email: publications_graphics@fca.org.uk or write to: Editorial and Digital team, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS

Abbreviations used in this paper

AIFM	Alternative Investment Fund Manager
APA	Approved Publication Arrangement
AR	Appointed Representative
ARM	Approved Reporting Mechanism
CA	Competent Authority
CBA	Cost benefit analysis
CIS	Collective investment scheme
COBS	Conduct of Business sourcebook
COLL	Collective Investment Schemes sourcebook
CP	Consultation Paper
CSA	Commission Sharing Agreement
CTP	Consolidated Tape Provider
DEA	Direct Electronic Access
DEPP	Decision Procedure and Penalties manual
DP	Discussion Paper
DRS	Data Reporting Service
DRSP	Data Reporting Services Provider
ECP	Eligible Counterparty
EEA	European Economic Area
EEOTC	Economically Equivalent Over the Counter

EG	the Enforcement Guide
EMP	Energy Market Participant
ESMA	European Securities and Markets Authority
EU	European Union
FSA	Financial Services Authority (predecessor to the FCA)
FSMA	Financial Services and Markets Act 2000
FUND	Investment Funds sourcebook
FX	Foreign Exchange
MAR	Market Conduct Sourcebook
MiFID	Markets in Financial Instruments Directive
MiFID II	Markets in Financial Instruments Directive II (includes MiFIR, where the context indicates)
MiFIR	Markets in Financial Instruments Regulation
MTF	Multilateral Trading Facility
OMP	Oil Market Participants
OTF	Organised Trading Facility
PERG	Perimeter Guidance
PRA	Prudential Regulation Authority
PROD	Product Intervention and Product Governance sourcebook
PRIIPs	Regulation on Packaged Retail and Insurance-based Investment Products
RAO	Regulated Activities Order
RDC	Regulatory Decisions Committee
REC	Recognised Investment Exchange sourcebook
RIE	Recognised Investment Exchange

RM	Regulated Market
RPA	Research Payment Account
RTS	Regulatory Technical Standard
SME	Small and Medium-sized Enterprise
SUP	Supervision Manual
SYSC	Senior Management Arrangements, Systems and Controls – FCA Handbook
TC	Training and Competence sourcebook
the Treasury	Her Majesty's Treasury
UCITS	Undertakings for collective investments in transferable securities

1. Overview

Introduction

- 1.1 The Markets in Financial Instruments Directive (MiFID) II is a package of EU legislation that regulates both retail and wholesale investment business, and will apply from 3 January 2018. Member States of the European Union (EU) must change their laws and regulations to implement MiFID II by 3 July 2017.
- 1.2 We have previously published four consultation papers (CPs) on the implementation of MiFID II: CP15/43, CP16/19, CP16/29, and CP16/43. We are publishing this fifth CP, alongside our first Policy Statement PS17/5.¹
- 1.3 We will publish a second PS, in June 2017, to cover all other issues on which we have consulted.
- 1.4 For ease of consultation, our Handbook text is prepared as if the amendments proposed in our previous consultations on MiFID II implementation have been made and are in force. We will of course take account of responses to the previous consultations in finalising the changes to our Handbook, both in respect of those proposed changes and the ones consulted on here.

Summary of proposals

- 1.5 In this CP, we seek views on proposed changes to the Handbook in the areas below:
 - **Specialist regimes – Occupational Pension Scheme (OPS) firms** – COBS 18 contains a number of tailored conduct regimes (covering MiFID and non-MiFID business) for specialist types of designated investment business, including OPS firms. OPS firms are exempt from MiFID and this will not change under MiFID II. But they are currently subject to conduct rules which implement MiFID. We have considered whether it makes sense to apply to them any of the revised conduct standards in MiFID II as we have done with other investment managers not subject to MiFID II. We are proposing to apply MiFID II standards relating to inducements (and, as part of this, research), best execution and taping to OPS firms.
 - **Decision Procedure and Penalties Manual (DEPP) and Enforcement Guide (EG)** – We propose changes to DEPP and EG to reflect various aspects of MiFID II including, but not limited to, the extension of our enforcement powers to cover persons subject to UK implementing legislation². These proposals will be subject to a six week consultation period.
 - **Consequential changes to the Handbook and reporting financial instrument reference data and positions in commodity derivatives** – We propose some consequential amendments to the Handbook based on proposals in CP16/29 (including some amendments to the Glossary), and guidance on the use of third parties where firms

¹ www.fca.org.uk/publications/consultation-papers/cp17-8-mifid-ii-implementation-proposals-v

² the Financial Services and Markets Act 2000 (Markets in Financial Instruments (Regulations) 2017 (the MiFI Regulations)

are required to send us financial instrument reference data or commodity derivative position reports. These proposals will be subject to a six week consultation period.

Equality and diversity considerations

- 1.6** We have considered the equality and diversity issues that may arise from the proposals in this consultation. Overall, we do not consider that the proposals in this CP 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.
- 1.7** 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.

Who does this consultation affect?

- 1.8** At the start of each chapter, we state to which firms it is most likely to be relevant. 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
 - recognised investment exchanges (RIEs)
 - multilateral trading facilities (MTFs)
 - prospective organised trading facilities (OTFs)
 - Data Reporting Service Providers (DRSPs)
 - OPS firms

Is this of interest to consumers?

- 1.9** Consumers have a clear interest in financial markets that operate fairly and transparently, which is the rationale for the proposals in this CP. Of the subjects covered, proposals relating to OPS firms will probably be of most concern to consumers. The proposals aim to improve the way that OPS firms discharge their obligations in regards to purchasing research and executing decisions to deal on behalf of pension schemes.

What do you need to do next?

- 1.10** We want to know what you think of our proposals. Please send us comments by 23 June 2017 for chapter 2 and 12 May 2017 for chapters 3 and 4.

How?

- 1.11** Use the online response form on our website or write to us at the address on page 2.

What will we do?

- 1.12** We will consider your feedback and publish our rules in the PS which we expect to publish in June 2017 for chapters 3 and 4. We will publish rules on the issues in Chapter 2, other than in regard to taping, separately.

2. Specialist regimes – Occupational Pension Scheme (OPS) firms

Who should read this chapter

Occupational pension scheme (OPS) firms and firms providing execution and research services to OPS firms

Introduction

- 2.1** COBS 18 contains a range of tailored conduct regimes for various types of specialist designated investment business, covering both MiFID and non-MiFID business. COBS 18.8 sets out the requirements for Occupational Pension Scheme (OPS) firms.
- 2.2** OPS firms undertake investment management on behalf of a group occupational pension scheme or trust. OPS firms' clients are the trustees, although the scheme assets are managed in order to meet liabilities owed by the scheme sponsor (usually a corporate entity) to pension scheme beneficiaries (e.g. current or former employees of that corporation). There are currently 17 authorised OPS firms that manage over £250bn in assets, the majority of which are MiFID financial instruments. OPS firms are outside the scope of MiFID and this remains the position under MiFID II.³
- 2.3** In 2007 the FSA applied its new COBS rules, many of which derived from MiFID, to OPS firms, including best execution and rules on the use of dealing commission. When the FSA introduced new taping rules in 2008, they also covered OPS firms.
- 2.4** MiFID II is enhancing key aspects of existing COBS rules, including best execution, and introduces new rules on inducements and research (replacing our dealing commission regime), telephone recording (taping) and record keeping.
- 2.5** In our third MiFID II implementation CP (CP16/29), we asked an open question on whether to extend the revised requirements on the record keeping of client orders, decisions to deal and transactions to OPS firms. We expect to finalise this position in our second MiFID II policy statement (whereas our final approach to the issues consulted on in this CP, other than taping, will be made at a later date).
- 2.6** In our fourth MiFID II implementation CP published in December 2016 (CP16/43), we discussed firms within the specialist regimes in COBS 18. However, we deferred consideration of OPS firms until we had carried out further policy and cost benefit analysis. Having completed this exercise, we propose to apply the MiFID II requirements relating to (i) inducements and, as part of this, research (ii) best execution and (iii) taping, to OPS firms. We view these requirements,

³ Under Article 2 of MiFID

alongside the record-keeping provisions, as the most important and relevant conduct of business rules for OPS firms.

- 2.7** We also propose to retain the application of two other sections of COBS to OPS firms. These are the sections of the chapter in COBS 11 (dealing and managing) relating to client order handling (COBS 11.3) and personal account dealing (COBS 11.7), which have not been materially changed under MiFID II. We also propose to retain the tailored periodic disclosure requirements for OPS firms that are currently contained within COBS 18.8.2R.
- 2.8** Otherwise, based on further analysis we believe that most provisions in COBS do not appear to be relevant to the nature of OPS firm business, we are proposing in this CP to switch off all other COBS provisions for OPS firms. However, we welcome views on this approach to ensure that no valuable investor protection measures will be lost as a result.
- 2.9** Our Asset Management Market Study (AMMS) is also of relevance to the regulatory framework for OPS firms. We have proposed in our AMMS interim report a package of remedies to address issues our work has found. In finalising the package of remedies we will build on the changes in MiFID II and the Packaged Retail and Insurance-based Investment Products Regulation (PRIIPs).

Existing provisions

- 2.10** Currently, COBS generally applies to an OPS firm when it carries out non-MiFID business, but with some modifications. These modifications are set out in COBS 18.8 and are aimed at reflecting the nature of the trustee/beneficiary relationship and the interaction of our regulatory requirements with other trust law obligations. The two current modifications to the application of COBS to OPS firms are to switch off COBS rules on client agreements (COBS 8) and apply a modified form of the client reporting requirements.

Proposals

- 2.11** We propose to apply the following aspects of the MiFID II regime to OPS firms:
- research and inducements
 - best execution
 - taping
- 2.12** We discuss each of these areas in more detail below, including the exact provisions this will involve and the implications of these changes.
- 2.13** As noted above, we also plan to continue to apply the following COBS requirements:
- COBS 11.3 – client order handling
 - COBS 11.7 – personal account dealing
 - COBS 16.2 and COBS 16.3 – reporting information to clients (as modified by COBS 18.8.2R)
- 2.14** In CP16/29, we consulted on maintaining the current application of transaction record keeping requirements in COBS 11.5 to OPS firms, although we also sought views on whether we should apply the new MiFID II standards. We expect to finalise our position on record keeping of client orders in the second MiFID II policy statement in June 2017.

- 2.15** COBS 18.8 will be deleted and replaced with new sections that indicate the particular COBS rules we propose to apply to OPS firms and how these will apply to their activities. For example, the new sections will set out how the MiFID II inducements and best execution requirements apply to OPS firms, and include provisions explaining how the requirements are modified to apply to OPS firms.
- 2.16** We propose to remove the current application of other aspects of COBS that are not referred to in this chapter, on the basis that they are redundant because they are not relevant to OPS firms' activities.

Research and Inducements

Proposals

- 2.17** In general, we propose to apply the new MiFID II inducements requirements for investment firms providing portfolio management services to OPS firms. The new provisions when applied to OPS firms will restrict their ability to receive inducements from third parties in relation to their management of scheme assets. In order to receive third party research, OPS firms will need to comply with the new MiFID II standards (which can be found in new COBS 2.3A and COBS 2.3B, as described in CP16/29). These new provisions will replace our existing use of dealing commission rules in COBS 11.6, which currently apply to OPS firms.
- 2.18** In respect of the draft Handbook provisions published in CP16/29, we propose to apply the following inducements and research-related provisions when the OPS firm carries on the specified⁴ OPS activity in relation to a MiFID financial instrument:
- Relevant provisions of COBS 2.3A as currently proposed to apply to MiFID firms providing portfolio management services. In particular, this includes COBS 2.3A.12R and COBS 2.3A.15R, and related guidance provisions COBS 2.3A.14G, COBS 2.3A.16G, COBS 2.3A.17-18G, and COBS 2.3A.26-27G.
 - Section COBS 2.3B, which provides an exemption to the inducements rules for third party research if relevant provisions are met.
- 2.19** Where an OPS firm carries on specified OPS activities in relation to a non-MiFID financial instrument, or when it is carrying out the OPS activities of safeguarding and administering investments or receiving or holding client money, we propose to apply the current inducements standards that apply to OPS firms under COBS 2.3. This distinction reflects the fact that we have seen more significant conflicts of interests and poor practices under our existing dealing commission and inducements rules in relation to firms' investment management activities and controls over transaction costs passed to underlying investors or funds (including pension schemes or trusts) when used to acquire third party research.
- 2.20** We have also proposed bespoke record keeping provisions in COBS 18.8A.8R and COBS 18.8A.11R which require OPS firms to retain evidence to demonstrate compliance with the applicable inducement rules. However, we view the general record-keeping provision in SYSC

⁴ In summary, the Handbook defines "OPS activity" as managing investments and carrying on the following activities in relation to the occupational pension scheme: dealing in investments (as principal or agent), arranging deals, making arrangements with a view to transactions in investments, safeguarding and administering investments, advising on investments and receiving or holding client money. We propose applying the new inducement standard in COBS 2.3A to OPS firms when they are carrying out any OPS activity except when the OPS firm is carrying on the OPS activities of safeguarding and administering investments and receiving or holding client money.

9.1.1R may already be sufficient, since it stipulates that firms must keep records of its business, including all services and transactions undertaken by it, such that the FCA is able to monitor the firm's compliance with applicable regulatory requirements. Subject to the views of stakeholders, we are therefore minded to omit the bespoke provisions linked to the inducement rules to simplify COBS 18.8A.

- 2.21** Consistent with MiFID II's approach, we also propose to require sell-side MiFID investment firms that supply both execution and research services to OPS firms to provide separate pricing of each service. We therefore also propose to amend COBS 2.3C.1R (see CP16/29) to apply this provision to investment firms providing execution services to OPS firms.

Implications for firms

- 2.22** The application of COBS 2.3A to OPS firms as proposed above in relation to managing scheme assets that are MiFID financial instruments will prevent them from receiving any third party benefits, except for minor non-monetary benefits. However, compliance with the requirements in COBS 2.3B – as applied to OPS firms – will allow OPS firms to receive third party research without the receipt of the research being regarded as an inducement. Under COBS 2.3B, firms will be required to either pay for research directly, or disclose a separate research charge applied to the underlying client's funds under management. If a separate charge is used, a firm must establish a budget for external research spending, and provide robust accountability and disclosures on subsequent payments made for research and the benefit research has to its client(s). It will require a clear separation of research costs from execution fees by OPS firms.
- 2.23** The scale of the changes required to implement MiFID II derived inducement requirements varies, and depends on the OPS firms' individual business model. Where they outsource all of their portfolio management activities, there will be no direct impact on the OPS firms. They will though benefit from enhanced disclosures and accountability over research spending where they use third party investment managers who are also subject to the MiFID II reforms.
- 2.24** Where an OPS firm does not outsource all of its portfolio management, the impact will depend on how it currently funds research and what model it choose to adopt to purchase research. If an OPS firm already pays for research directly, there would be no cost since they will already comply. Where they currently receive external research linked to execution commissions, they will need to consider moving either to a research payment account (RPA) model or paying for research directly. If an OPS firm chooses to operate an RPA, compliance costs will reflect the extent to which they need to enhance their governance and oversight of research compared to their current use of dealing commission arrangements for equities to meet the MiFID II-derived rules in COBS 2.3B.
- 2.25** Our engagement with OPS firms and responses to our cost benefit analysis (CBA) survey point to relatively modest one-off implementation costs and lower ongoing costs for those that will incur costs. The majority of OPS firms also indicated support for extending standards in this area. Several commented that, as a matter of best practice, they would seek to achieve similar standards irrespective of whether we required them to comply with the enhanced inducement requirements of the MiFID II regime. The application of these MiFID II standards to OPS firms will enable them to exercise greater scrutiny and control when spending scheme money on third party research.
- 2.26** There will be no change in the inducements standard in relation to any OPS firm activity that does not involve the management of, or transactions relating to, scheme assets that are MiFID financial instruments.

Implications for firms providing execution and research services

- 2.27** Based on our proposals, firms that provide both execution and research services to OPS firms (eg brokers) will have to extend separate pricing of services to these firms. However, since we already propose to require these firms to do so when supplying services to MiFID investment firms and firms carrying out non-MiFID collective portfolio management activities, we anticipate no additional cost or impact from this incremental extension to the small number of OPS firms.

Implications for consumers

- 2.28** Pension scheme (or welfare trust) trustees should receive much more transparency from the OPS firm on the amount spent on research and be able to apply more scrutiny to the benefit that such research has for the scheme. In turn, this means that members of OPS pension schemes or beneficiaries of welfare trusts should benefit from better governance in the research procurement process which could feed through to lower fees paid for portfolio management activities, higher net investment returns and the ensuing improvement in the matching of the schemes' assets and liabilities.
- 2.29** Overall, as set out in our CBA, we think the potential benefit from cost efficiencies in the use of third party research by OPS firms on behalf of pension fund trustees and scheme members should outweigh the potential costs.

Wider implications

- 2.30** More widely, as large asset holders, OPS firms have an important role to play in ensuring that increased scrutiny on research charges translate into more effective oversight and transparency in the market. This could benefit consumers at large by lowering the cost of investing.

Policy considerations

- 2.31** MiFID II inducement reforms prevent portfolio managers from (a) accepting and retaining any monetary benefits (which will need to be rebated to clients) or (b) accepting any non-monetary benefits other than minor non-monetary benefits, where such inducements are received from or on behalf of third parties. Specific new rules on research, which will replace our dealing commission regime, will, however, introduce a qualified exemption from this ban to allow portfolio managers to receive third party research that is received in compliance with specific requirements.
- 2.32** In this respect, MiFID II introduces important reforms that are designed to address the conflict of interest and inducements risks posed by existing market practice whereby brokers provide valuable research goods and services to portfolio managers in return for higher execution commission charges borne by the underlying client's portfolio. MiFID II also enhances firms' transparency and accountability to investors over research costs to ensure that these are properly controlled. In line with our current consultation proposals to apply the MiFID II standards on inducements and research to collective investment managers, including UCITS management companies and AIFMs, we propose to level-up the same requirements for OPS firms that are already subject to our domestic dealing commission rules.
- 2.33** In our view, this has the potential to benefit the trustees, scheme sponsor and the members who should reap the benefits of a more accountable and rigorous approach to research spending by the OPS firm. This should ultimately translate into improved long term sustainability of the scheme thus reducing funding needs for the corporate and insolvency risk for the scheme members.
- 2.34** By complying with the MiFID II inducement and research related requirements, OPS firms, scheme trustees, sponsors and scheme members could also benefit from enhanced transparency on the cost, quality and benefits of research.

2.35 More broadly, given their bargaining power, we consider that large institutional asset holders such as OPS firms have an important role to play in ensuring that increased oversight and transparency around research charges translates into effective cost controls across the board. This could benefit consumers at large by lowering the cost of investing through increased competition and a more effective management of the resources dedicated to research.

References

2.36 The existing application provisions for OPS firms are in COBS 18.8.

2.37 The existing rules for inducements and the dealing commission regime are in COBS 2.3 and COBS 11.6 respectively.

2.38 The draft Handbook provisions to implement the new inducements and research rules under MiFID II can be found in Appendix 1 of CP16/29, in COBS 2.3A, 2.3B and 2.3C (see pages 57-74 of the Appendix).

Q1: Do you agree with our proposal to apply the MiFID II inducements and research standards that apply to the provision of portfolio management services to OPS firms? If not, please explain why.

Q2: Do you agree that the record keeping requirement in SYSC 9.1.1R should ensure OPS firms keep adequate records to demonstrate compliance with the applicable inducement provisions, and can replace the bespoke record keeping requirements proposed in COBS 18.8A.8R or COBS 18.8A.11R?

Best Execution

Proposals

2.39 We propose to apply the enhanced MiFID II best execution requirements to OPS firms, replacing the current MiFID derived best execution rules in COBS 11.2. We set out our proposed transposition of the new MiFID II best execution provisions in CP16/29, as a new section COBS 11.2A.

2.40 In particular, application of the best execution standards in COBS 11.2A to OPS firms will require them to:

- meet a stricter overarching best execution obligation
- provide more specific disclosures
- check the fairness of the price when executing orders or dealing in OTC products
- report annually on the top five execution venues and brokers they have used and the quality of execution obtained

Implications for firms

2.41 OPS firms are already subject to the existing MiFID best execution standards, so the main impacts arise from the incremental enhancements MiFID II makes to these standards. OPS firms

will need to review and upgrade their current best execution practices, policies and disclosures to reflect the MiFID II requirements.

- 2.42** The majority of these changes under MiFID II are incremental improvements to the best execution regime and are not expected to significantly impact already compliant OPS firms. Nevertheless, firms should review and update their execution arrangements and policies in order to meet the enhanced MiFID II requirements. MiFID II raises the threshold of the best execution standard that firms must meet in to deliver best execution to their clients. Instead of taking all *reasonable* steps, firms must now take all *sufficient* steps to obtain the best possible results for their clients when carrying out client orders.
- 2.43** Where firms execute or take decisions to deal in OTC products, MiFID II obliges firms to check the fairness of the price quoted to clients by gathering market data and where possible, comparing against similar products.⁵ OPS firms may need to take further steps to improve their systems and controls to ensure they achieve and can evidence best execution in OTC markets.
- 2.44** MiFID II also strengthens existing provisions in relation to the content and quality of information disclosure to be provided to clients in firms' execution policies. The firm will be required to detail how it determines its choice of execution venues and provide a summary of its monitoring of best execution. Firms will also need to disclose the costs of using different venues and explain any differences, as well as information on any third party payments. OPS firms will therefore need to review their policies and may need to add more specific detail as necessary, particularly for the disclosures made to their clients, such as pension fund trustees.
- 2.45** While the measures described above build upon the existing framework (and are therefore likely to have less impact on already compliant firms), the key change to the best execution regime for firms carrying out client orders relate to the obligation to publish an annual report listing the top five entities to which client orders were sent in the preceding year and a summary of the outcomes of the execution monitoring over that period.⁶ We expect OPS firms will have to set up new systems and processes to publish the necessary data to comply with this new obligation. However, the core information required by Article 65(6) of the MiFID II delegated regulation (by reference to RTS 28) should be already available to firms under the current best execution regime.

Implications for consumers

- 2.46** The new MiFID II best execution provisions should strengthen the content and quality of disclosure to clients (in this case the trustees of the OPS firm) to the ultimate benefit of the beneficial owners of the scheme. These measures should provide greater transparency on execution quality and how and where orders are executed.
- 2.47** We expect that the introduction of these new disclosure requirements will help reduce information asymmetries between OPS firms and their trustee clients, and between OPS firms and third party investment firms they may use. This will allow trustees to make better informed decisions in assessing the OPS firms' performance, and improve OPS firms' ability to assess the third parties they may wish to work with. These new requirements should also enable clients to reasonably monitor and challenge their service providers. We expect that these measures should help to improve competition amongst the third party brokers, whether used directly by the OPS firms or via third party managers, with any resulting reduction in execution costs or improvements in execution quality benefitting the underlying scheme.

⁵ Article 65(3) of the MiFID II Delegated Regulation, which cross-refers to Article 64(4) of the same

⁶ For portfolio managers, this is required by Article 65(6) of the MiFID II Delegated Regulation, which applies the reporting obligation and establishes that this must be consistent with Regulatory Technical Standard 28 developed under Article 27(10)(b) of MiFID II.

Policy considerations

- 2.48** We propose to apply the MiFID II best execution provisions to OPS firms, given that they present similar issues for the purposes of best execution as firms carrying out collective portfolio management activities. The enhanced disclosure and transparency should enable clients, such as trustees, to better assess and compare the merits of their service providers or a chosen investment strategy, and how this ultimately impacts the performance of the pension scheme or welfare trust. Trustees and beneficiaries of OPS or welfare trust assets should benefit from improved levels of investor protection and transparency in line with the wider market.
- 2.49** In CP16/29 we consulted on extending the enhanced MiFID II best execution requirements to other firms that receive and transmit or place client orders with other entities for execution, including UCITS management companies, reflecting our view that ensuring that clients receive best execution is a fundamental obligation on firms. We propose taking the same approach for OPS firms so we have consistent market-facing standards across different forms of investment management, which we believe are appropriate given the scale of assets they manage.
- 2.50** OPS firms are currently required, based on rules we copied across from MiFID, to provide best execution to their clients. Depending on the scale of their activities and business model, our proposals will require firms to review their existing practices and make some upgrades to their current execution arrangements and disclosures to reflect the improved MiFID II best execution standard.
- 2.51** The new MiFID II provisions address policy concerns regarding investor protection, transparency and market efficiency. The enhanced best execution requirements strengthen the existing framework with respect to execution monitoring, broker and venue selection as well as reducing the information asymmetries between firms and their clients. These measures are fully consistent with the findings of our thematic review (TR14/13)⁷ and further supervisory work conducted on buy-side firms last year, which uncovered poor practice across a number of areas of best execution and found that the fundamental information asymmetry made client scrutiny difficult. These findings are equally applicable in the context of OPS firms.
- 2.52** The MiFID II requirements are intended to increase disclosure to clients, provide transparency around execution arrangements and order routing decisions, and should facilitate greater investor challenge and scrutiny by clients on the performance of firms acting on their behalf. The application of the MiFID II best execution requirements should ensure consistent standards of investor protection and transparency with respect to OPS firms carrying out portfolio management activity in MiFID financial instruments.
- 2.53** Several OPS firm responses to our CBA survey supported uniform standards in line with other firms carrying out economically equivalent activities. If the additional transparency improves efficiency in transaction costs, it should improve pension funds' returns, which in turn should reduce funding costs for sponsors and the risk for scheme members that any shortfall in scheme value may mean future benefits cannot be paid (e.g. if the sponsor went into liquidation). There may also be wider, positive market impacts of common best execution standards and reporting, e.g. through increased competition between firms who provide execution services to OPS firms.

Q3: Do you agree with our proposal to apply the MiFID II best execution standards to OPS firms? If not, please explain why.

⁷ <https://www.fca.org.uk/publication/thematic-reviews/tr14-13.pdf>

Taping

Proposals

2.54 We propose to apply the MiFID II taping requirement to OPS firms, replacing our current provisions in COBS 11.8 and the qualified exemption available to discretionary investment managers, including OPS firms. This will mean OPS firms will have to adhere to the following set of requirements based on the draft Handbook instrument published as part of CP16/29:

- SYSC 10A that requires recording of telephone conversations and electronic communications with all clients where these relate to, or are intended to lead to, the conclusion of a transaction, even where the transaction is not concluded. It also requires records to be stored for five years, with the option for the Competent Authority to extend the requirement to seven years in specific cases.
- Further organisational requirements, which are set out in Article 76 of the MiFID II delegated regulation.

Implication for firms

2.55 We do not believe that the costs of implementing the new MiFID II organisational requirements for OPS firms that currently tape will be significant, because the changes are incremental in nature.⁸

2.56 However, we do expect there to be one-off and on-going costs for those OPS firms that make use of the current qualified exemption to taping that is available to discretionary investment managers. We proposed in CP16/29 to remove this qualified exemption and so all OPS firms will be required to tape relevant telephone conversations. This will mean introducing new technology, adhering to the new taping organisational requirements and making changes to existing technological frameworks.

Implication for consumers

2.57 We do not expect trustees as the clients of the OPS firm, nor the underlying beneficiaries of OPS schemes or welfare trusts, to notice any changes in the day-to-day management of the pension scheme assets. However, OPS firms, as consumers of services from sell-side firms, will have an additional tool to check post trade reconciliations without having to rely on the counterparty to retrieve the recording. This should ensure that any disputes that may arise with counterparty firms are resolved more speedily and efficiently. The OPS firm will also be better placed to detect any misconduct by its staff, for example personal account dealing. This could reduce or prevent costs or lost performance that trading errors or any misconduct could incur on the scheme, benefitting the scheme sponsor and beneficiaries.

2.58 Recording the telephone conversations of OPS firms could also have a wider benefit for market integrity and cleanliness, as it will improve the FCA's ability to investigate any potential market abuse or market conduct issues with OPS firms and may act as a deterrent. Although OPS firms may be less likely to act inappropriately, the fact that they manage over £250bn in MiFID financial instruments means that if any such issues did emerge they could have a material impact on confidence in UK markets. Reducing this risk could thus have a marginal benefit to all UK consumers who interact with financial markets.

Policy considerations

2.59 OPS firms are currently required to tape certain conversations under COBS 11.8 because they place orders with other entities for execution that result from decisions by the firm to deal

⁸ This assessment is based on the feedback we received to our MiFID II CBA survey undertaken in 2015

on behalf of its client. However, a qualified exemption for discretionary investment managers allows them the option of not recording their conversations and electronic communications with other firms that are subject to the taping rules when such conversations and communications are infrequent.

- 2.60** In CP16/29 we proposed removing this qualified exemption because we have observed shortcomings with it for portfolio managers during supervisory and enforcement investigations including difficulties in obtaining the relevant records as we only have access to those records from the ‘sell-side’. Removing the exemption will also reduce the costs and burden on those firms who are not the actual subjects of our enforcement or supervisory investigations. At the time the FSA introduced the exemption, technology was also more rudimentary and data storage costs higher than they are now.
- 2.61** We now propose to apply MiFID II taping standards to OPS firms and remove the exemption, meaning that any OPS firms that currently avail themselves of the exemption will be subject to the taping requirement. We also propose to apply the new MiFID II taping organisational requirement to OPS firms too.
- 2.62** The main rationale for this approach is that taping provides an important protection for OPS firms. It will allow them to resolve trading disputes with brokers more easily and at less cost in the event of trading errors and also detect any staff misconduct, such as personal account dealing. However, as noted above, it will also provide a tool for the FCA to investigate any potential market abuse issues that may arise.
- 2.63** Our proposed approach is supported by responses by OPS firms to a CBA survey we conducted, in response to which seven out of ten OPS firms stated that they already tape conversations, despite the fact they could choose to be exempt under our rules. The proportionality appears further justified by the general consensus in the CBA responses that our estimates on the reduced costs of taping and storage are realistic.

References

- 2.64** The existing rules are at COBS11.8.
- 2.65** The relevant provisions for taping are:
- Articles 16(7) of MiFID II
 - Article 76 of the MiFID II delegated regulation

Questions

- Q4: Do you agree with our proposal to remove the qualified exemption to taping for OPS firms? If not, please give reasons why.**
- Q5: Do you agree with our proposal to apply the MiFID II taping (including organisational) requirements to OPS firms? If not, please give reasons why.**

Modifications and commencement date

2.66 We have included some additional rules in the draft instrument to explain how particular words or phrases in the new COBS provisions that we propose to apply to OPS firms should be understood when being applied to OPS firm activity. For example, COBS 18.8A.2R(1) explains how existing references in COBS to ‘client’ should be understood when that word is found in rules applying to OPS firms. Similarly, in COBS 18.8A.5R(2) we explain how references to ‘independent advice’, ‘investment service’ and ‘portfolio management’ should be understood when found in a COBS rule that is to apply to an OPS firm. However, we are keen to understand whether our approach provides sufficient clarity for OPS firms, or whether any other terms would benefit from a further explanatory provisions in COBS 18.8A.

2.67 We propose to have a commencement date of 3 January 2018 for the changes proposed in COBS 18.8A. Based on the survey responses from OPS firms, we understand that the majority of firms are already aware of and planning for changes under MiFID II in the areas where we propose to apply new standards. We therefore view that it should not be unduly burdensome for firms to meet the new standards by this date, and will have the benefit of ensuring enhanced investor protection standards apply sooner and in alignment with MiFID II’s application date for MiFID investment firms. However, we recognise that the final rules will not be published until the second half of 2017, following this consultation period. We therefore welcome views on whether the implementation period is feasible or if we should consider an alternative date.

Q6: Are there any other words, terms or phrases that are used in the COBS provisions that will apply to OPS firms that need to have their meaning modified when applied to OPS firms? Please explain why you believe any other words, terms or phrases would benefit from having their meaning modified.

Q7: Do you agree with our proposal to apply the new provisions from 3 January 2018? If not, please indicate what you think would be a more appropriate commencement date.

Other aspects of COBS

2.68 Our understanding of the OPS firm business model suggests that it has only one client – the trustees who are appointed to act on behalf of the pension scheme or welfare trust beneficiaries. On that basis, we have assessed that other aspects of COBS that are not discussed in this Chapter are not relevant to this business model.

2.69 We therefore propose, on the grounds of proportionality and rational regulation, to switch off all of the other requirements in COBS. This will include the following rules: client categorisation (COBS 3), communicating with clients (COBS 4), information about the firm (COBS 5), client agreements (COBS 8), suitability (COBS 9), appropriateness (COBS 10), preparing product information (COBS 13) and providing product information to clients (COBS 14). However, we welcome feedback from the industry on this proposed approach.

Q8: Do you agree with our proposal to dis-apply other areas of COBS for OPS firms or are there any other areas of COBS we should continue to apply? Please explain your views.

3.

Decision Procedure and Penalties Manual (DEPP) and Enforcement Guide (EG)

Who should read this chapter

Prospective DRSPs; firms trading commodity derivatives or economically equivalent over-the-counter contracts; persons engaged in algorithmic trading, providing the services of direct electronic access (DEA) to a Regulated Market (RM) or Multilateral Trading Facility (MTF) or providing the service of acting as a general clearing member; and investment firms, credit institutions, and Recognised Investment Exchanges (RIEs).

Introduction

- 3.1** In this chapter we set out our proposed changes to DEPP and EG.
- 3.2** These changes are based on the proposed implementing statutory instruments: the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017 (the MiFI Regulations) and the Financial Services and Markets Act 2000 (Data Reporting Service) Regulations 2017 (the DRS Regulations).

Existing Provisions

- 3.3** The majority of the enforcement powers required by MiFID II are already available to the FCA.⁹ The main exception to this is the new power to require investment firms, credit institutions and recognised investment exchanges to remove persons from their management boards, as well as powers over DRSPs and certain other entities subject to requirements under the MiFI Regulations.
- 3.4** This consultation also addresses the cooperation and exchange of information provisions between CAs with ESMA, and cooperation with non-EEA countries.

Proposals

- 3.5** We have identified the following key areas requiring changes to DEPP and EG. These include:
- the regime relating to position limits and other requirements applicable to certain authorised and unauthorised firms
 - enforcement powers relating to the above, as well as new powers to require the removal of person from management boards

⁹ Under Parts IVA (Permission to carry on regulated activities), V (Performance of regulated activities), XI (Information Gathering and Investigations), XIV (Disciplinary measures and XXV (Injunctions and Restitution) of FSMA as may be amended and applied by the MiFI Regulations and the DRS Regulations

- the new regime for DRSPs¹⁰

3.6 Some procedural changes have been made to the governance of cooperation between CAs, non-EEA countries and ESMA. However, we do not believe any changes to EG or DEPP are necessary as a result.

Position limits and obligations applying to certain persons exempt from authorisation

3.7 Some obligations in MiFID II apply to unauthorised firms, as well as authorised firms.

3.8 MiFID II introduces an obligation on CAs to establish and enforce limits to the net positions which persons may hold in commodity derivatives and EEOTC. As these position limits will apply to all firms, a standalone position limits regime has been put in place, which will apply to both authorised and unauthorised persons¹¹. The FCA is given the supervisory power to intervene in three areas: to limit the ability of a person to enter into a contract for a commodity derivative; to restrict the size of the position a person may hold in such a contract; and to require a person to reduce the size of a position held. If the FCA imposes a limitation, restriction, or requirement it must give a notice to the person¹².

3.9 Specific operating requirements apply to certain entities in circumstances where they are otherwise exempt from being authorised. These include obligations on certain persons engaged in algorithmic trading, providing the services of DEA to a RM or MTF or providing the service of acting as a general clearing member, and obligations in relation to the synchronisation of business clocks.¹³

3.10 The FCA may impose a requirement on a person to whom the above obligations apply if it appears that the person has contravened, or is likely to contravene a requirement imposed on it under the MiFI Regulations or MiFIR; the person has in purported compliance with any requirement imposed on it under the MiFI Regulations or MiFIR, knowingly or recklessly given the FCA false or misleading information; or it is desirable to do so to advance one or more of the FCA's objectives. This may be a requirement to take specified action or to refrain from taking such action. If the FCA imposes a requirement it must give a notice to the person.¹⁴

3.11 We propose to add the above new notices to the list of supervisory notices set out in DEPP 2, Annex 2G and to make it clear that the decision to give a notice exercising these powers will be taken by FCA staff under executive procedures.

3.12 It should be noted that the FCA is only required to give a single supervisory notice when exercising its powers under Regulations 19 and 27 of the MiFI Regulations. There will be no right to make representations to the FCA after the issuing of this notice, but the matter can be referred to the Tribunal.

3.13 MiFI Regulations give the FCA powers to investigate (by applying Part 11 FSMA) and impose sanctions for contraventions as provided for by those Regulations. Sanctions include public censure¹⁵ and financial penalties¹⁶ which can be imposed on authorised, as well as unauthorised,

¹⁰ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/418287/Annex_B_-_Data_Reporting_Services_Regs_-_Consultation_Final.pdf

¹¹ This regime is set out in Part 3 of the MiFI Regulations.

¹² Regulation 19

¹³ These obligations are set out in Part 4 of the MiFI Regulations.

¹⁴ Regulation 27

¹⁵ Regulation 37

¹⁶ Regulation 38

persons subject to the relevant requirements under the MiFI Regulations. The FCA must give a person a warning notice when proposing, and a decision notice when deciding, to impose a sanction on that person. We propose to add these new notices to the list of warning and decision notices set out in DEPP 2, Annex 1G and to make it clear that the decisions to issue a warning notice and a decision notice will be taken by the Regulatory Decisions Committee, as is currently the case with analogous FSMA powers.

- 3.14** In addition to the above, we propose to add a new section to Chapter 19 of EG, setting out our approach to conducting investigations and enforcing the applicable obligations under the MiFI Regulations.

Removal of persons from management boards

- 3.15** The FCA has a new power¹⁷ to require an investment firm, credit institution or a RIE to remove a person from its management board. This power is conferred for the purpose of all the FCA's functions under MiFID II. We propose adding high-level guidance in EG 19 about the way in which this power will be exercised. The approach will be reasonable and proportionate, taking into account all relevant circumstances.

- 3.16** The decision to give a notice removing a person from a management board will be taken by the Regulatory Decisions Committee.

DRSPs

- 3.17** MiFID II obliges member states to require that the provision of DRS, as a regular occupation or business, be subject to prior authorisation. These activities are not specified activities within the Financial Services and Markets Act 2000 (Regulated Activities Order 2001) (RAO). The DRS Regulations create a specific regime for DRSPs outside of the RAO.

- 3.18** The DRS Regulations provide a high level supervisory regime for DRSPs, with disciplinary measures and offences provided for in Part 7. The proposed changes to FSMA and standalone provisions in the DRS Regulations will result in the FCA having regulatory power over DRSPs. These include the powers to:

- require information and appoint investigators
- enter and inspect premises under warrant
- impose public censures and financial penalties
- impose limitations and other restrictions
- apply for an injunction, require restitution and prosecute unauthorised providers

- 3.19** We propose to add a new section to Chapter 19 of EG (Non-FSMA powers), describing our approach to the conduct of investigations and enforcing the requirements imposed by or under the DRS Regulations. This approach will broadly mirror how the FCA investigates, imposes sanctions and utilises its FSMA regulatory powers.

- 3.20** The DRS Regulations, require us to give DRSPs a warning notice and decision notice in certain circumstances. These include when proposing or deciding to:

¹⁷ Under Part 5 of the MiFI Regulations (implementing Article 69(2)(u) of MiFID II).

- cancel a person’s verification¹⁸ or authorisation other than at their request¹⁹.
- refuse a person’s request to vary their verification²⁰ or authorisation²¹.
- refuse an application for verification²² or authorisation²³
- impose a restriction on an applicant²⁴
- refuse a request to cancel a person’s authorisation²⁵
- impose a public censure²⁶
- impose a financial penalty²⁷
- require restitution²⁸

3.21 We propose to add these new notices to the list of warning and decision notices set out in DEPP 2, Annex 1G and to align the decision making process, and the decision makers specified, with our current approach to analogous FSMA powers.

3.22 The FCA is also required to give DRSPs a written notice when imposing a limitation or other restriction.²⁹

3.23 We propose to add this new notice to the list of supervisory notices set out in DEPP 2, Annex 2G and to align the decision making process, and the decision makers specified, with our current approach to analogous FSMA powers.

Application of our penalty policy

3.24 Article 72(2) MiFID II (exercise of supervisory powers and power to impose sanctions) requires Member States to ensure that CAs take into account all relevant circumstances, including ‘where appropriate’ the non-exhaustive list of factors in Article 72(2), when determining the type and level of a relevant administrative sanction or measure (namely, a sanction or measure imposed in exercise of a power provided for in Article 70 MiFID II).

3.25 We propose to apply our existing penalties policy as set out in DEPP 6 in relation to imposition of public censures and financial penalties under MiFID II. We do not believe there are any special circumstances or features which require or merit a change to the FCA’s current policy. We consider that our existing policy already sets out factors embodying the substance of those set out in Article 72(2).

Cooperation with CAs and cooperation with third countries

18 Regulation 8

19 Regulation 11

20 Regulation 8

21 Regulation 12

22 Regulation 8

23 Regulation 10

24 Regulations 8 and 10

25 Regulation 11

26 Regulation 32

27 Regulation 33

28 Regulation 36

29 Regulation 34

3.26 Articles 79-87 of MiFID II build on the procedures, previously established by MiFID, governing cooperation between CAs of the Member States and with ESMA. These articles also set out the procedures relating to the obligation to cooperate, cooperation between CAs and the exchange of information and cooperation with non-EEA countries. We believe our existing cooperation obligations as set out in FSMA are broad enough to cover these revised requirements.

3.27 We do not propose amending EG to refer this part of MiFID II. We will follow the procedure relating to requests for cooperation, and exchange of information as currently set out.

Implications for firms

3.28 DRSPs will be subject to the same FCA decision making procedures as other authorised persons (and prospective authorised persons) when seeking authorisation or when dealing with the variation or cancellation of their authorisation. Authorised and unauthorised persons, subject to MiFID II requirements enforceable under the MiFI Regulations or the DRS Regulations will be subject to the same decision making procedures and penalty policy currently applied by the FCA when it takes enforcement action against authorised persons.

Implications for consumers

3.29 It is in consumers' interests that firms, including DRSPs and entities trading commodity derivatives or persons engaged in algorithmic trading, providing the services of DEA to a RM or MTF or providing the service of acting as a general clearing member and obligations in relation to the synchronisation of business clocks, comply with their MiFID II obligations. This will strengthen the integrity of the UK's financial markets.

References

3.30 Title VI, Chapter I of MiFID II (Articles 67-78) includes the powers of CAs.

3.31 The Treasury's policy statement dated 16 February 2017 'Transposition of the Markets in Financial Instruments Directive II: response to consultation'³⁰ includes the proposed implementing statutory instruments.

Q9: Do you have any comments regarding our proposed implementation approach and the amendments we propose to make to DEPP and EG?

³⁰ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/590504/PU2037_MIFID_final_web.pdf

4. Consequential changes to the Handbook and reporting financial instrument reference data and positions in commodity derivatives

Who should read this chapter

Firms performing investment services and activities and recognised investment exchanges

Introduction

- 4.1** In the course of our previous consultations on the implementation of MiFID II, we have sought in several areas to deal with consequential changes to the Handbook at the same time as making the substantive changes. There is, however, additional updating which we have undertaken as part of the current consultation. Our overall aim is to bring the Handbook and associated material into line with the changes we are proposing to make as a part of implementing MiFID II. This section sets out our proposals for these mainly consequential changes to the Handbook, together with proposals for guidance on the use of third parties for trading venues and investment firms that have to send certain data to our Market Data Processor (MDP).

Proposals

- 4.2** We propose to make some consequential changes to the Handbook that follow on from the proposals we consulted on in CP16/29. As well as some small amendments to the Glossary, the changes are:
- **Emission allowance bidding** – The changing scope of MiFID II in relation to emission allowances means that we are proposing an amendment to the definition of ‘auction regulation bidding’ to bring this into line with the directive, notably to reflect the fact that a MiFID investment firm will be subject to the directive when bidding in a spot emission allowance. As such the scope of ‘auction regulation bidding’ (a subset of the activity of bidding in emissions auctions) will be narrower as of MiFID II application.
 - **Client assets (CASS)** – We are proposing consequential changes such as removing the opt in at CASS1.4.9R made redundant by the narrowing of the definition of auction regulation bidding.
 - **Reporting to clients** – In paragraph 5.68 of CP16/29 clarified that 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 continue to apply as they do now. These rules require the disclosure of trade confirmation and periodic information as detailed in COBS 16 Annex 1R, an annex which currently cross-refers to information contained in SUP 17 Annex 1. As a result of policy that has been consulted on separately, SUP 17

Annex 1 will be deleted. So, in line with the policy intent set out in CP16/29, in this CP we are proposing consequential amendments to COBS 16 Annex 1R so it will no longer refer to SUP 17 Annex 1 but will, instead, detail all the potentially relevant information to be disclosed to clients that was listed in that annex.

We do not expect that any additional burden will apply to firms as we are not proposing changes to the substance of our rules. Indeed, affected firms may find the revised lay-out more convenient as details of all the information they may potentially need to provide to clients will now be listed in one place.

Q10: Do you agree with our proposal to amend these modules? If not please give reasons why.

- 4.3** In CP16/43 we consulted on guidance – see Chapter 4 – concerning the use of third parties in connection with transaction reporting by investment firms and trading venues. In responding to that consultation respondents posed questions about the use of third parties in other instances where investment firms and trading venues have to send us data, financial instrument reference data and commodity derivative position reports. We are therefore proposing guidance on these two issues in SUP 17A and MAR 10 respectively.
- 4.4** The guidance in SUP 17 we are proposing makes clear that operators of trading venues and investment firms sending financial instrument reference data to our MDP can use third parties, to send us the information. It also clarifies the position in respect of connecting to the MDP for SIs. The guidance in MAR 10 we are proposing makes clear that trading venues sending us daily reporting positions in commodity derivatives and investment firms sending us position reports relating to trading in economically equivalent over-the-counter (EEOTC) commodity derivative contracts to our MDP can use third parties to do so. It also makes clear that investment firms may submit position reports to us via a trading venue. If an ARM is being used we would not regard it as operating within the scope of its authorisation as an ARM but as a provider of outsourcing services.

Q11: Do you agree with our proposed guidance in SUP 17 on reporting of financial instrument reference data? If not, please give reasons why.

Q12: Do you agree with our proposed guidance in MAR 10 on reporting of data on positions in commodity derivative contracts? If not, please give reasons why.

Annex 1

List of questions

- Q1:** Do you agree with our proposal to apply the MiFID II inducements and research standards that apply to the provision of portfolio management services to OPS firms? If not, please explain why.
- Q2:** Do you agree that the record keeping requirement in SYSC 9.1.1R should ensure OPS firms keep adequate records to demonstrate compliance with the applicable inducement provisions, and can replace the bespoke record keeping requirements proposed in COBS 18.8A.8R or 18.8A.11R?
- Q3:** Do you agree with our proposal to apply the MiFID II best execution standards to OPS firms? If not, please explain why.
- Q4:** Do you agree with our proposal to remove the qualified exemption to taping for OPS firms? If not, please give reasons why.
- Q5:** Do you agree with our proposal to apply the MiFID II taping (including organisational) requirements to OPS firms? If not, please give reasons why.
- Q6:** Are there any other words, terms or phrases that are used in the COBS provisions that will apply to OPS firms that need to have their meaning modified when applied to OPS firms? Please explain why you believe any other words, terms or phrases would benefit from having their meaning modified.
- Q7:** Do you agree with our proposal to apply the new provisions from 3 January 2018? If not, please indicate what you think would be a more appropriate commencement date.
- Q8:** Do you agree with our proposal to dis-apply other areas of COBS for OPS firms or are there any other areas of COBS we should continue to apply? Please explain your views.
- Q9:** Do you have any comments regarding our proposed implementation approach and the amendments we propose to make to DEPP and EG?

- Q10:** Do you agree with our proposal amend these modules?
If not please give reasons why.
- Q11:** Do you agree with our proposed guidance in SUP 17A on reporting of financial instrument reference data? If not, please give reasons why.
- Q12:** Do you agree with our proposed guidance in MAR 10 on reporting of data on positions in commodity derivative contracts? If not, please give reasons why.

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, CP16/19, CP16/29 and CP16/43 we provided an overview of EU work on the impact of MiFID II and its relevance to the UK. In this CBA we present our cost-benefit analysis of the proposals in this CP.

Specialist regimes – Occupational Pensions Scheme (OPS) firms

2. There are currently seventeen OPS firms operating in our market. We sent our CBA questionnaire to all of these firms, ten of which responded.

Research and Inducements

Introduction

3. MiFID II introduces strengthened rules on inducements for firms providing portfolio management services and independent investment advice, and sets out specific provisions for how third party research can be received and paid for without being considered as an inducement.
4. The proposal analysed for the purpose of this CBA is to level-up the current inducements regime applicable to OPS firms to bring it into line with the MiFID II requirements for portfolio managers, in relation to their investment management and dealing activities involving scheme assets that are MiFID financial instruments.

Rationale for Intervention

5. Under our current use of dealing commission rules, OPS firms, along with other types of investment managers, can receive third party research in return for agreeing to pay higher transaction commissions to brokers when executing trades on behalf of the underlying pension scheme (or welfare trust), which directly bears these costs. This creates a potential conflict of interest since the asset owners are bearing the cost for research services received by the OPS firm managing their assets. As a result of asymmetric information, the asset owners are not in a position to judge the value and benefit of the service consumed by the OPS firm and so cannot assess whether the extra costs they incur are in their best interests.
6. Supervision of our use of dealing commission rules in recent years has detected that few firms apply adequate rigour and oversight when receiving research from third parties, in particular executing brokers, in return for dealing commissions. This can lead to higher transaction costs and poor value for money for investors.³¹ In particular, we found that where firms fund research through transaction commissions, amounts paid to brokers for research often fluctuated with trading volumes rather than an objective assessment of the value and benefit of research services received. In an OPS firm context, a similar lack of oversight of these costs and the resultant inefficiencies will negatively impact the performance of the pension scheme or welfare trust.

³¹ See Discussion Paper 14/3 for a report on supervisory findings from thematic supervisory work in 2013/14. Follow up work in 2016 found many firms are still not applying adequate scrutiny in this area, as reported in the Asset Management Market Study Interim Report, paras. 7.54-7.68 (MS15/2.2).

7. As detailed above, MiFID II will demand much more accountability by portfolio managers over research costs, in the interests of investors and asset owners. Extending these new MiFID II standards consistently to OPS firms will address our continued supervisory concerns that there is insufficient oversight of the procurement of research and control over the associated costs by firms managing assets on behalf of others. Common standards across the market will also help drive a more efficient research market by promoting pricing and a focus on value for money by both suppliers and consumers such as OPS firms.

Baseline for Analysis

8. OPS firms are currently subject to the dealing commission rules contained in COBS 11.6 and to the wider inducements regime set out in COBS 2.3. We assume for the baseline of this CBA that OPS firms are in compliance with these requirements.

Costs

Scope of costs

9. A majority of the ten OPS firms who responded to our survey supported an extension of the MiFID II research and inducements standards to their business, notwithstanding potential costs. Costs from extending the MiFID II inducements and research requirements will only arise for OPS firms where they manage assets directly. Where they outsource all of their investment management activity, we believe the OPS firm itself will not incur any direct costs from our discretionary decision to extend the MiFID II inducements reforms. In these cases, the enhanced standards will be delivered through the third party investment managers they use, where they are subject to our proposed COBS 2.3B rules.
10. For those OPS firms that do not outsource the portfolio management of all of the pension scheme or welfare trust assets, we have calculated potential one-off and ongoing costs based on the survey returns. In some cases, firms identified specific costs or indicated they felt there would be no or minimal incremental costs. We have assumed that most firms incurring costs will seek to implement a 'research payment account' model with consequently higher compliance expense due to the enhanced accountability and governance this requires. However, two of those firms indicating no incremental costs have already adopted a model of paying for research separately as a direct cost to the OPS firm, rather than funding it through execution services – hence they consider they are already compliant.
11. Based on our proposals, firms that provide both execution and research services to OPS firms (e.g. brokers) will have to extend separate pricing of services to these firms. However, since we already propose to require these firms to do so when supplying services to MiFID investment firms and firms carrying out non-MiFID collective portfolio management activities, we anticipate no additional cost or impact from this incremental extension.
12. For the purposes of assessing costs, we exclude from our analysis any transfer in existing research costs between the firm and the client. We also do not consider as costs any potential changes in tax treatment as a result of the reforms, such as the application of VAT to research services, which is in any case uncertain at this stage. This is consistent with our approach in CP16/29.

i) One-off costs

13. As noted above, three of the respondents outsource all of their portfolio management activities to third parties and thus we believe that they will bear no direct costs as a result of our discretionary proposals to extend inducement reforms.
14. Of the seven OPS firms who do not fully delegate portfolio management to third parties, five reported that they were likely to incur one-off costs to comply with our proposal, while two

noted zero costs. OPS firms indicating one-off costs stated that they expect these to include the renegotiation of current commission sharing agreements (CSAs) to move to RPAs, legal fees and changes in systems, training and governance to implement the new approach. Based on survey responses and using figures provided,³² we have estimated an average one off cost per firm of £35,000 to comply with an extension of the MiFID II inducements and research requirements.

15. To calculate the likely one-off costs across the full population of seventeen OPS firms, we calculated a range with a lower and upper bound. The lower bound takes the proportion of firms who do not outsource all of their portfolio management and who provided specific estimates of one-off costs in our survey (40%) and applies the average cost per firm to 40% of the 17 firms in the population. This provides a lower bound one-off cost estimate of £238,000. For the upper bound, we assume costs are incurred by all firms that don't outsource (70% based on our survey), and therefore apply the average cost across 70% all the OPS firms. This gives an upper bound one-off cost figure of £416,500.

ii) Ongoing costs

16. By contrast to one-off costs, only two OPS firms who do not fully outsource their portfolio management provided specific estimates of ongoing costs from the proposals. These costs could relate to the need to regularly review budgets and the cost of the RPA infrastructure, especially if it is outsourced to a third party provider. Two other firms stated that they expected some costs but did not provide any estimates, while another three stated they anticipated no additional ongoing costs from meeting enhanced MiFID II standards.³³ We assume the lower provision of cost figures for ongoing expenses may be because some OPS firms take the view that once an RPA and revised governance arrangements are initially put in place, ongoing costs to monitor and oversee spending on research may not materially differ from those currently incurred when overseeing existing dealing commission arrangements. Based on survey responses that gave some indication of likely costs and figures provided, the average ongoing cost per firm is estimated to be £20,833.
17. We estimate a lower bound ongoing cost estimates for the whole OPS firm sector by taking the proportion of firms who do not outsource all of their portfolio management and who provided specific estimates of ongoing costs in our survey (20%) and applying the average cost per firm to 20% of the 17 firms in the total population. This provides a lower bound ongoing cost estimate of £70,833. For the upper bound, we assume average costs are incurred by all firms that don't outsource (70%). Applying the average cost per firm across 70% of the 17 OPS firms gives an upper bound ongoing cost figure of £247,916.

Benefits

18. Extending the application of the MiFID II inducements and research framework to OPS firms should result in better control and oversight of the cost and quality of the third party research they consume, reducing the overall costs of their in-house or delegated portfolio management activities. This will reduce costs passed on to the pension scheme or welfare trust, which should improve performance and reduce potential shortfalls in pension scheme funding that could impact the end beneficiaries, such as members of the scheme and / or scheme sponsors, such as the corporate issuer responsible for funding benefits.

³² Of the five firms who did not outsource all of their portfolio management and indicated they were likely to incur one off costs, four provided estimates of those costs. One of these estimates was removed from our calculation of average costs as an outlier. In addition, one firm who outsourced all of their portfolio management also provided one-off cost estimates.

³³ In addition one firm who outsourced all of their portfolio management who provided cost estimates in relation to one-off costs did not indicate ongoing costs.

19. Based on the level of equity assets that are MiFID financial instruments which are managed by OPS firms that do not outsource all of their portfolio management, if we assumed a saving of 1 bps of cost every year on the value of these assets from better scrutiny of research costs, OPS firms could save nearly £6.2m per annum on behalf of the pension scheme or welfare trust.³⁴ This estimate does not capture the potential benefits for two of the firms for which we do not have data on assets under management.
20. Consistent with our approach in CP16/29, for fixed income and other asset classes, we have assumed the impact on costs and benefits may be broadly net-neutral in the short term. This is because separate payments for research on fixed income may offset any potential reduction in transaction costs passed to clients, or any net difference is likely to be very small.
21. The enhanced standards should also encourage OPS firms to focus on sourcing and purchasing better quality research, which could have further though less tangible performance benefits if better research helps to inform better investment decisions.
22. Given OPS firms' significant assets under management and their strong bargaining power as a result, we also consider that applying these reforms to them may lead to wider benefits of improving competition in the research market due to the pressure they can exert on research pricing and quality offered by suppliers.

Best Execution Introduction

23. In line with the approach adopted when implementing MiFID, we are proposing a general application of the improved MiFID II provisions to OPS firms, on a discretionary basis, where their business involves the execution of orders, placing orders for execution as part of portfolio management services, or the reception and transmission of orders to other entities for execution.
24. This is consistent with the approach we have proposed in CP16/29 for other non-MiFID firms carrying out collective portfolio management (CPM) activities such as UCITS management companies, residual CIS operators and AIFMs. As OPS firms carry out economically equivalent activities to MiFID portfolio managers, our proposed approach to apply common best execution requirements, in line with their industry counterparts, will help ensure consistent standards of investor protection and transparency.
25. 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. We believe these aims are equally relevant for OPS firms. This approach 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. While TR 14/13 did not specifically cover OPS firms, its findings are equally relevant for firms undertaking investment management activities where they have a duty to act in the best interests' of their underlying clients.
26. 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

³⁴ We calculate this figure by taking the AuM of the firms in our CBA response that do not fully outsource management activity. Based on data from survey responses, we assume 88% of these assets are MiFID financial instruments and, of these, 56% are equities. We also assume that 77% of these funds are actively as opposed to passively managed, based on the Investment Association's figures for the UK asset management sector as a whole. Based on this estimate of funds impacted, we calculate the benefits of a 1bps saving. We apply the same methodology to 70% of the known AuM of the seven OPS firms that did not respond to our survey, assuming the same proportion of outsourcing as per our survey responses. We excluded from the benefits calculation the AuM of OPS firms that stated they outsource all of their portfolio management activity and the residual 30% of the AuM assumed to be entirely outsourced by OPS firms not responding to the CBA survey. Source: 'Asset Management in the UK 2015-16' <<http://www.theinvestmentassociation.org/assets/files/research/2016/20160929-amsfullreport.pdf>>.

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, OPS firms will be required to disclose additional detail in their execution policies (e.g. information on venue selection and fees and third party payments).

27. MiFID II also establishes new reporting requirements linked to best execution. Under MiFID II RTS 28, firms must report annually on the top five brokers or venues to which they sent client orders for execution and a summary of the analysis and conclusions drawn from their monitoring of execution quality. MiFID II also imposes an equivalent obligation on portfolio managers and receivers and transmitters to produce a report consistent with the RTS 28.
28. The annual reports consistent with RTS 28 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. Further, the additional reporting will provide clients and other third parties, with valuable tools that will reduce information asymmetries and help them select which firms they wish to work with. By extending this reporting requirement to OPS firms, it will provide trustees with additional useful and relevant information to ensure that they are apprised of where orders are routed to on behalf of the scheme or trust.

Rationale for Intervention

29. OPS firms are already subject to MiFID rules on best execution, the core principles of which remain unchanged in MiFID II. However, our supervisory work on buy-side firms and thematic work suggests that firms still fall short of delivering best execution for their clients effectively.
30. A majority of OPS respondents indicated support for extending standards in these areas. Some are already moving to the higher MiFID II standard or outsource all of the scheme management to MiFID firms, and so would gain the MiFID II standard with no (or negligible) direct cost to the OPS firm as a result of the discretionary decision to extend MiFID II best execution requirements to OPS firms. Several OPS firms stated that they felt it was important that they should be subject to the same market standards as those applied to other forms of investment managers and viewed this as consistent with their legal obligations to the pension scheme trustees.
31. 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.
32. 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 a consistent basis.
33. 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.
34. 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. 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

35. The relevant baseline against which we measure the additional impacts of applying the MiFID II requirements on best execution to OPS firms is the current best execution requirements these OPS firms are subject to under COBS 11.2.
36. 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 OPS firms to provide more detailed execution policies and information disclosure to their trustees.
37. While we would expect most OPS 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 prescribe such detail and so some firms may need to improve their arrangements to meet the MiFID II standard.
38. The most significant change MiFID II will introduce is the obligation for firms to publish reports, on a yearly basis, of the top five brokers or entities to which they have sent orders and a summary of their execution quality monitoring from the preceding year (as set out in RTS 28). While implementing this new reporting requirement is likely to involve some costs to OPS firms, we think these reports would be of value for trustees, given that OPS firms are engaged in primarily transmitting orders via a broker.

Costs

Likely scope of costs

39. Three of the OPS respondents stated that they delegate portfolio management activities entirely to other MiFID firms. These OPS firms are thus not expected to incur direct costs as a result of our discretionary proposals, since the enhanced standards will be provided by those firms to which they outsourced. By contrast, seven out of 10 OPS firms do not outsource all of the portfolio management activity, and may therefore incur costs as a consequence of our discretionary proposals.
 - i) ***One-off costs***
 40. 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.
 41. Since OPS firms have told us that they 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 the new requirements in relation to upgrading their execution arrangements and policies to reflect the enhanced MiFID II standards.
 42. The main one-off costs firms will face is in relation to the publication of an annual report (MiFID II RTS 28) setting out the top five venues or brokers to which client orders were sent in the preceding year as well as a summary of execution quality achieved over that period. Based on survey responses from OPS firms that do not outsource all of their portfolio management activity, four firms provided estimates of specific one-off costs they would incur, while three

did not.³⁵ The average cost per firm based on survey responses and the figures provided is estimated to be £49,730.

- 43.** We calculate a lower bound of one-off costs across the sector by taking the proportion of firms who do not outsource all of their portfolio management and who provided specific estimates of one-off costs in our survey (40%) and applying the average cost per firm to 40% of the full 17 firms in the population. This provides a lower bound one-off cost estimate of £338,164. For the upper bound, we assume average one-off costs are incurred by all OPS firms that do not outsource all of their portfolio management (assumed at 70% based on survey responses), to give an upper bound total one-off cost figure of £591,787.

ii) Ongoing costs

- 44.** We expect ongoing costs to be lower than one-off costs, as once new systems are in place based on the new best execution standards, the monitoring and review processes will not be materially different to what firms are already expected to do under the existing rules. Additional ongoing costs will mainly be related to the OPS firms' annual production of RTS 28. Based on survey responses and figures provided, we estimate an ongoing cost per firm of £21,880.³⁶
- 45.** We estimate a lower bound of total one-off costs across the sector by taking the proportion of firms who do not outsource all of their portfolio management and who provided specific estimates of ongoing costs in our survey (30%) and applying the average cost per firm to the same proportion of all 17 OPS firms. This provides a lower bound ongoing cost estimate of £111,588. For the upper bound, we assume average ongoing costs are incurred by all OPS firms that do not outsource all of their portfolio management (assumed at 70% based on survey responses), to give an upper bound total one-off cost figure of £260,372.

Benefits

- 46.** MiFID II will increase transparency on execution quality and is expected to improve due diligence and oversight of execution practices in OPS firms. Applying a similar approach across MiFID portfolio managers (which was included for consultation in CP16/29) and OPS firms would ensure that consumers benefit from consistent standards of information disclosure and investor protection.

The RTS 28 reporting requirements introduced by MiFID II will require firms to provide information on order routing, execution, fees and rebates etc. These reports are intended to provide trustees, employees and beneficiaries 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. There is also an expectation that this will feed into firms' monitoring of their own execution quality as well as giving trustees a useful tool to challenge their brokers and service providers.

- 47.** To provide an indicative figure on potential benefits, we estimate that if OPS firms undertaking portfolio management activity (e.g. not fully outsourcing it) saved 1bps in execution costs on the total value of the MiFID financial instruments they manage, assuming a 60% portfolio

³⁵ Of the four firms who did not outsource all of their portfolio management and provided estimates on one off costs, one of these estimates was removed from our calculation of average costs as an outlier. In addition one firm who outsourced all of their portfolio management also provided one-off cost estimates.

³⁶ Three firms who did not outsource all their portfolio management provided us with specific cost estimates of ongoing costs. In addition one firm who outsourced all of their portfolio management who provided cost estimates in relation to one-off costs did not indicate on-going costs.

turnover³⁷, then they could save around £17m per year.³⁸ This estimate does not capture the potential benefits for two of the 17 OPS firms for which we do not have data on assets under management. Any savings in transaction costs would result in improved performance of pension scheme or welfare trust assets.

48. More broadly, we expect the introduction of these reporting requirements could have a positive market impact in encouraging greater competition between brokers and venues to the ultimate benefit of consumers, not just OPS firms and their members. Since extending these requirements will make even more information available across the market about the quality of execution services, including fees and costs, there could be more pressure on brokers or venues to provide high quality, cost efficient execution to retain and attract client order flow.

Taping Introduction

49. 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. In this CP, we are proposing to extend to OPS firms the new taping requirements under MiFID II in relation to their dealing activities on behalf of the schemes they manage, and remove the existing qualified exemption available to them under our COBS rules. This CBA provides our assessment of the anticipated impacts of our proposal.

Rationale for intervention

50. 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.
51. In our view, taping will help OPS firms to be able to resolve disputes with its brokers more easily and at less cost, as it allows them to produce their own records in case of for example, a trading error. The OPS firm will also be better placed to detect any misconduct by its staff, for example personal account dealing. This could reduce or prevent costs or lost performance that trading errors or any misconduct could incur on the scheme, benefitting the scheme sponsor and beneficiaries.
52. Any saving for the OPS firm in time and cost of a dispute process will in turn benefit the scheme and its beneficiaries. It will improve the FCA's ability to supervise, since we will be able to obtain tapes directly from OPS firms if we are examining their activities, which we would not currently be able to if they avail themselves of the exemption. Although misconduct by OPS firms may be less likely given the nature of their business, the scale of their activity – with over £250bn in MiFID financial instruments – in our view makes it appropriate to ensure there are adequate records to examine in case any risk to market integrity emerged.

37 We received limited responses from our survey as to the level of portfolio turnover for OPS firms. Given this, we assume an average total portfolio turnover of 60%, based on the methodology in TR14/13. In relation to fixed income assets, portfolio turnover maybe lower or higher than this assumption. Correspondingly, this would lead to a lower or higher estimation of benefits in relation to the impacts of our best execution proposals on fixed income assets.

38 We calculate this figure by taking the AuM of the firms in our CBA response that do not fully outsource their portfolio management activity. Utilising data from survey responses, we assume 88% of these AuM are MiFID financial instruments. Based on the methodology in TR14/13 we apply an average portfolio turnover of 60% (for a round-trip trading value of 120%) and a cost saving of 1bps. We apply the same methodology to 70% of the known AuM of the seven OPS firms that did not respond to our survey, assuming the same proportion of outsourcing as per our survey responses. We excluded from the benefits calculation the AuM of OPS firms that stated they outsource all of their portfolio management activity and the residual 30% of the AuM assumed to be entirely outsourced by OPS firms not responding to the CBA survey. Source: 'TR14/13 – Best execution and payment for order flow' < <https://www.fca.org.uk/publication/thematic-reviews/tr14-13.pdf> >

Baseline for analysis

53. Without action by us, OPS 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, such as OPS firms.
54. 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.
55. To the extent that OPS firms do not apply the exemption, the baseline is already fairly close to the new proposals.

Costs

Likely scope of costs

56. Seven OPS respondents stated that they already tape conversations. For these firms, we believe the additional costs of meeting the MiFID II requirements would be relatively low. For the remaining three respondents we would expect that they would incur additional costs as a result of our discretionary proposal to tape.
57. Where costs were commented on by respondents, several agreed with our analysis of costs provided in CP16/29. In addition, two of the three respondents who did not tape viewed the requirement as either not affecting them or having a minimal impact.

Direct costs

58. The greatest costs incurred by firms required to implement a taping system would be related to installing a new taping infrastructure. This would include the one-off development costs and ongoing costs, for example for ongoing taping and electronic storage (assumed to be in a third party cloud). Our cost estimates include mobile recording as well as fixed recording, using a ratio of fixed users to mobile of 1:0.44.
59. 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.
60. 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.

61. Based on the assumption that 30% of the OPS population do not currently tape, we estimate that the costs of applying the taping requirements to OPS firms will range between £56,695 and £63,945 for one off costs and between £53,795 and £61,045 for ongoing costs.³⁹

Benefits

62. Estimating the benefits of taping is not reasonably practicable. However, in our view, 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. This will help OPS firms to be able to resolve disputes with its brokers more easily and at less cost, as it allows them to produce their own records in case of e.g. a trading error for example when an OPS firm places an order with a broker for execution.
63. We also see benefits in terms of the self-disciplining effect of taped calls i.e. when an employee knows that the conversation is taped, they are more likely to adhere to their conduct of business obligations.
64. 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. Indeed, 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 therefore see many upsides to removing the qualified exemption available to OPS firms.

Other aspects of COBS

65. We are proposing to dis-apply all other parts of COBS that are not explicitly turned on in the proposed new COBS 18.8 section, as detailed above. Currently, OPS firms are subject to a general application of COBS with a few limited modifications. Based on our analysis, we think those COBS sections we are now turning off are not relevant to their activities.
66. We therefore do not anticipate any material costs or benefits for OPS firms from this change. However, if there is any impact at all, there could be a benefit for an OPS firm in the form of marginal compliance cost savings if they can fully disregard sections of COBS where they may currently take steps to periodically review provisions and monitor for any regulatory developments across all of COBS even where they are not applicable. We do not believe any such benefit could be reasonably quantified given it is unlikely to be material.

³⁹ 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.

Enforcement Guide (EG) and Decision Procedure and Penalties Manual (DEPP)

67. Under section 138I of FSMA, when the FCA wishes to introduce any new rules it must publish a cost benefit analysis (CBA) along with the proposed rules. The proposals set out in this Chapter do not relate to rule changes or guidance on rules and do not impose additional obligations on firms. These proposals recommend applying our current policy and procedures to breaches of requirements under MiFID II and MiFIR and new sanctions that may be imposed under the MiFI Regulations and the DRS Regulations. Our current procedures will also apply when we consider authorisation applications or impose other measures under these Regulations. Depending on the provision in question, we either have no discretion in implementation or the proposed approach will not be substantially different from the FCA's current approach. The FCA does not expect that the proposal will lead to any increase in costs, or the cost increase will be of minimal significance if compared with any reasonable counterfactual. Consequential changes to the Handbook, reporting financial instrument reference data and positions in commodity derivatives.
68. 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. They do not reflect any change in policy. We do not therefore believe these consequential changes will add any significant costs or benefits to those expected from MiFID II as addressed in our previous consultations.

Reporting financial instrument reference data and positions in commodity derivatives

Introduction

69. We are proposing guidance to clarify in relation to financial instrument reference data, commodity derivative position reports and data related to transparency and double volume cap calculations, that trading venues and investment firms can make the use of third parties to assist them in sending information to our MDP.

Costs

70. We consider that there will not be any incremental costs to firms as a result of these proposals or that any incremental costs will be of minimal significance. The guidance is permissive; it clarifies how trading venues and investment firms can make use of third parties in sending information to our MDP, therefore it creates greater choice over how firms can comply with their reporting obligations.

Benefits

71. We consider that these proposals will provide benefits to operators of trading venues and investment firms who are systematic internalisers or trading in commodity derivatives, relative to not using third parties, as a result of them benefitting from specialism and economies of scale amongst third party providers of reporting solutions. The benefits cannot be reasonably estimated in light of the fact that we currently have no information on the extent to which firms might use third parties in sending information to our MDP on financial instrument reference data, commodity derivative position reports and data related to transparency and double volume cap calculations.

Annex 3

Compatibility statement

Compatibility with the FCA's general duties

This annex follows the requirements set out in section 138I FSMA. When consulting on new rules, we are required by section 138I 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

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 provisions ensuring an effective enforcement regime under MiFID II.
- strengthening investor protection ensuring an appropriate degree of protection for consumers through revisions to the regime in COBS 18 for OPS firms.

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.

We do not believe that our proposals discriminate against any particular business model or approach.

The principle that we should exercise our functions as transparently as possible.

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.

For the proposals in this CP where we have discretion 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.

We believe the proposals in this CP containing burdens or restrictions are proportionate to the benefits.

The desirability of publishing information relating to persons, or requiring persons to publish information.

We have had regard to the desirability of publishing information in our proposals.

Expected effect on mutual societies

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 equally, according to the powers exercised and to whom they are addressed, regardless of whether it is a mutual society or another authorised body.

Equality and diversity

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.

Our equality impact assessment (EIA) suggests that our proposals do not result in direct discrimination for any of the groups with protected characteristics (i.e. 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.

Appendix 1

Draft Handbook text

MIFID 2 (ENFORCEMENT, OCCUPATIONAL PENSION SCHEME FIRMS 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 137A (The FCA’s general rules);
 - (b) section 137B (FCA general rules: clients’ money, right to rescind etc);
 - (c) section 137T (General supplementary powers); and
 - (d) section 139A (Power of the FCA to give guidance);
 - (2) the powers of direction, guidance and related provisions in or under the following provisions of the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017 [(SI 2017/XXXX)]:
 - (a) regulation 17 (Power to require information);
 - (b) regulation 35 (Guidance);
 - (c) regulation 36 (Reporting requirements);
 - (d) regulation 41 (Statements of policy); and
 - (e) regulation 50 (Application of Part 26 of the Act);
 - (3) the powers of direction, guidance and related provisions in or under the following provisions of the Financial Services and Markets Act 2000 (Data Reporting Services) Regulations 2017 [(SI 2017/XXXX)]:
 - (a) regulation 22 (Guidance);
 - (b) regulation 48 (Statement of policy); and
 - (c) regulation 49 (Application of Part 26 of the Act); and
 - (4) 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 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).

(1)	(2)
Glossary of definitions	Annex A
Senior Management Arrangements, Systems and Controls sourcebook (SYSC)	Annex B
Conduct of Business sourcebook (COBS)	Annex C
Client Assets sourcebook (CASS)	Annex D
Market Conduct sourcebook (MAR)	Annex E
Supervision manual (SUP)	Annex F
Decision Procedure and Penalties manual (DEPP)	Annex G

Material outside the Handbook

- E. The Enforcement Guide (EG) is amended in accordance with Annex H to this instrument.

Citation

- F. This instrument may be cited as the MiFID 2 (Enforcement, Occupational Pension Scheme Firms and Miscellaneous Provisions) Instrument 2017.

By order of the Board
[date] 2017

[*Editor's note:* The text in the following Annexes takes into account the changes proposed by CP15/43 *Markets in Financial Instruments Directive II Implementation – Consultation Paper I* (December 2015); CP16/19 *Markets in Financial Instruments Directive II Implementation - Consultation Paper II* (July 2016); CP16/29 *Markets in Financial Instruments Directive II Implementation – Consultation Paper III* (September 2016) and CP16/43 *Markets in Financial Instruments Directive II Implementation – Consultation Paper IV* (December 2016); as well as the near-final rules proposed by PS17/5 *Markets in Financial Instruments Directive II Implementation – Policy Statement I* (March 2017) as if they were made.]

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

<i>auction regulation bidding</i>	<p>the <i>regulated activity</i> of <i>bidding in emissions auctions</i> where it is carried on by ÷</p> <p>(a) a <i>firm</i> that is exempt from <i>MiFID</i> under article 2(1)(i); or (j)</p> <p>(b) a <i>MiFID investment firm</i> (other than a <i>UCITS investment firm</i>) on behalf of its <i>clients</i> in relation to a <i>two-day emissions spot</i> .</p>
<i>material interest</i>	<p>(in <i>COBS</i>) (in relation to a transaction) any interest of a material nature, other than ÷</p> <p>(a) disclosable <i>commission</i> on the transaction ÷</p> <p>(b) goods or services which can reasonably be expected to assist in carrying on <i>designated investment business</i> with or for <i>clients</i> and which are provided or to be provided in compliance with <i>COBS</i> 11.6.3R .</p>
<i>MiFID client money (minimum implementing) rules</i>	<p><u>CASS 7.11.1R, CASS 7.11.4AR, CASS 7.11.59R, CASS 7.12.1R, CASS 7.12.2R, CASS 7.13.3R, CASS 7.13.8R, CASS 7.13.10R, CASS 7.13.12R, CASS 7.13.20R, CASS 7.13.21R, CASS 7.13.21AR, CASS 7.13.21CR, CASS 7.13.22R, CASS 7.13.26R, CASS 7.13.28R, CASS 7.15.2R, CASS 7.15.3R, CASS 7.15.20R.</u></p>
<i>OPS firm</i>	<p>(a) (except in <i>IPRU(INV)</i>) a <i>firm</i> which:</p> <p>(i) carries on <i>OPS activity</i>; and</p> <p>(ii) is one or more of the following:</p> <p>...</p>

(C) a *company* which is:

...

(III) an administering authority subject to the Local Government Pension Scheme (Administration) Regulations 2008 or the Local Government Pension Scheme (Transitional Provisions, Savings and Amendment) Regulations 2014; or

...

*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 9 of the *MiFID Org Regulation*]

(2) (in *CONRED*) a recommendation ~~which~~ that is *advice on investments* and:

...

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.

10A Recording telephone conversations and electronic communications

10A.1 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

...

~~(h)~~ that carries on *energy market activity* or *oil market activity*;

~~(j)~~ ~~and~~ or

~~(k)~~ is an *OPS firm*; and

...

Annex C

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 General application

...

Auction regulation bidding

1.1.1C R ~~The following rules in COBS apply~~ 5 (Distance communications) applies to a firm in relation to its carrying on of *auction regulation bidding* ~~;~~

(1) ~~COBS 5 (Distance communications);~~

(2) ~~(for a firm that has exercised an opt in to CASS in accordance with CASS 1.4.9R in relation only to those clients for which it holds client money or safe custody assets in accordance with CASS) COBS 3 (Client categorisation), COBS 6.1.7R (Information concerning safeguarding of designated investments belonging to clients and client money), COBS 6.1.11R (Timing of disclosure) and COBS 16.4 (Statements of client designated investments or client money).~~

...

2 Conduct of business obligations

...

2.3C Research and execution services

Application

2.3C.1 R This section applies to an *investment firm* providing execution services to:

...

(6) an incoming EEA AIFM branch; or

(7) an OPS firm.

...

16 Reporting information to clients (non-MiFID provisions)

...

16
Annex
1R

Trade confirmation and periodic information

This annex forms part of *COBS* 16.2.1R

	The information below must be provided, where relevant for the purposes of reporting to a retail client, in accordance with SUP 17 Annex 1	(1) Trade confirmation information	(2) Periodic information (where trade confirmation information is not provided on a transaction by transaction basis, to be provided for each transaction carried out during the reporting period)
General			
...			
7.	...		
7A.	<u>the underlying instrument identification (Note 1);</u>	<u>Y</u>	<u>Y</u>
7B.	<u>the instrument type (Note 2);</u>	<u>Y</u>	<u>Y</u>
7C.	<u>the maturity date (Note 3);</u>	<u>Y</u>	<u>Y</u>
7D.	<u>the derivative type (Note 4);</u>	<u>Y</u>	<u>Y</u>
7E.	<u>put/call (Note 5);</u>	<u>Y</u>	<u>Y</u>
7F.	<u>the strike price (Note 6);</u>	<u>Y</u>	<u>Y</u>
7G.	<u>the price multiplier (Note 7);</u>	<u>Y</u>	<u>Y</u>
...			
9.
9A.	<u>the counterparty;</u>	<u>Y</u>	<u>Y</u>
10.
10A.	<u>the quantity notation (Note 8);</u>	<u>Y</u>	<u>Y</u>
...			
17.	the <i>client's</i> responsibilities in relation to the settlement of the	Y	

	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 <i>client</i> ; and		
18.	if the <i>client's</i> counterparty was the <i>firm</i> itself or any person in the <i>firm's group</i> or another <i>client</i> of the <i>firm</i> , the fact that this was the case unless the order was <i>executed</i> through a trading system that facilitates anonymous trading;	Y	
19.	<u>the transaction reference number (Note 9); and</u>	<u>Y</u>	<u>Y</u>
20.	<u>the customer / client identification (Note 10).</u>	<u>Y</u>	<u>Y</u>
A <i>firm</i> may provide the <i>client</i> with the information referred to in this Annex using standard codes if it also provides an explanation of the codes used.			
<u><i>Firms</i> are reminded that COBS 16.2.1R only requires a <i>retail client</i> to be provided with the <i>trade confirmation information</i> that applies to them. Where a piece of information is not applicable to the circumstances of a particular trade, the <i>firm</i> is not required to report that information to the <i>client</i> or to include the field on the confirmation.</u>			
<u>The following Notes explain certain of the information requirements in the table above.</u>			
<u>Note 1</u>	<u>This is the instrument identification applicable to the security that is the underlying asset in a derivative contract.</u>		
<u>Note 2</u>	<u>This is the harmonised classification of the instrument that is the subject of the transaction (e.g. equity, bond). This item is only required when an explanation of the instrument type has not been provided in relation to the instrument identification in line 7.</u>		
<u>Note 3</u>	<u>This is the maturity date of a bond or other form of securitised debt, or the exercise date/maturity date of a derivative contract. Where the derivative type is spread bet on an equity option or contract for difference on an equity option, the expiry of the option must be indicated.</u>		
<u>Note 4</u>	<u>This is the harmonised description of the derivative type (e.g. option, future, contract for difference, complex derivative, warrant, spread bet,</u>		

	<u>credit default swap or other swap).</u>
<u>Note 5</u>	<u>This is only relevant when the instrument is an option, warrant, spread bet on an equity option or contract for difference on an equity option. Where the instrument is a spread bet on an equity option or a contract for difference on an equity option this field should be used to indicate the put/call status of the equity option.</u>
<u>Note 6</u>	<u>This is only relevant when the instrument is an option, warrant, spread bet on an equity option or contract for difference on an equity option. Where the instrument is a spread bet on an equity option or a contract for difference on an equity option this field should be used to indicate the strike price of the equity option.</u>
<u>Note 7</u>	<u>This is the number of units of the instrument in question which are contained in a trading lot; for example, the number of derivatives or securities represented by one contract.</u>
<u>Note 8</u>	<u>This should be used to indicate whether the quantity is the number of units of the instrument, the nominal value of bonds, or the number of derivative contracts.</u>
<u>Note 9</u>	<u>This should be the unique identification number for the transaction provided by the <i>firm</i>.</u>
<u>Note 10</u>	<u>This is the identity of the <i>client</i> or customer on whose behalf the <i>firm</i> was acting.</u>

...

18 Specialist regimes

...

Chapter 18.8 (OPS firms – non scope business) is deleted in its entirety. The deleted text is not shown.

18.8 OPS firms – non scope business [deleted]

Insert the new 18.8A after the deleted COBS 18.8 (OPS firms – non scope business). All of the text is new and not underlined.

18.8A OPS firms

Application

18.8A.1 R This section applies to an *OPS firm* when it carries on *OPS activity*:

- (1) from an establishment maintained by it in the *United Kingdom*; and
- (2) which is not *MiFID*, *equivalent third country* or *optional exemption business*.

Interpretation

- 18.8A.2 R Where a *COBS rule* specified in this section applies to an *OPS firm*, the following modifications apply:
- (1) References to:
 - (a) “*client*”, (including *retail client* and *professional client*) are to be construed as references to the *occupational pension scheme* or *welfare trust*, as the case may be, in respect of which the *OPS firm* is acting or intends to act, and with or for the benefit of whom the relevant business is to be carried on;
 - (b) “*investment firm*” are to be construed as a reference to an *OPS firm*.
 - (2) If an *OPS firm* is required by a *COBS rule* specified in this section to provide information to, or obtain consent from, a *client*, that *firm* must ensure that the information is provided to, or consent obtained from, each of the trustees of the *occupational pension scheme* or *welfare trust* for whom that *firm* is acting.
 - (3) Subject to the modification in *COBS 18.8A.14R(2)*, *COBS 1.2.3R* (References in *COBS* to the *MiFID Org Regulation*) applies where a *COBS* provision marked “EU” applies to an *OPS firm*.

General rule

- 18.8A.3 R Except as specified in this section, the provisions of *COBS* do not apply to an *OPS firm* in relation to its *OPS activity*.

Inducements: OPS activity in relation to financial instruments

- 18.8A.4 R The *COBS* provisions in Table 1 apply to an *OPS firm* when it carries on any *OPS activity* in relation to a *financial instrument* other than:
- (1) *safeguarding and administering investments*; or
 - (2) receiving and holding *client money*.

Table 1	
COBS	Description
2.1.1R	The client’s best interest rule

2.3A.12R	Inducements relating to the provision of independent advice and portfolio management services to professional clients
2.3A.14G	Guidance relating to fees, commission, and non-monetary benefits paid or provided by a person on behalf of a client
2.3A.15R	Acceptable minor non-monetary benefits
2.3A.16G	Guidance about determining whether a minor non-monetary benefit is capable of enhancing the quality of the service provided to a client
2.3A.17G	Guidance on what constitutes acceptable minor non-monetary benefits
2.3A.18G	Guidance on what constitutes acceptable minor non-monetary benefits
2.3A.26G	Guidance on inducements
2.3A.27G	Guidance on inducements

Modification of inducement rules specified in Table 1

- 18.8A.5 R (1) The *client's best interest rule* applies only in relation to the application of the inducement *rules* that Table 1 lists as applying to an *OPS firm*.
- (2) Where a provision of *COBS* specified in Table 1 applies, references to "*independent advice*", "*investment service*", "*portfolio management*" and "*relevant service*" are to be construed as a reference to *OPS activity*.

Inducements: *OPS activity* other than in relation to financial instruments

- 18.8A.6 R The *COBS* provisions in Table 2 apply to an *OPS firm* when it carries on any *OPS activity* other than any activity to which *COBS* 18.8A.4R applies.

Table 2	
COBS	Description
2.1.1R	The client's best interest rule
2.3.1R, other than (2)(b)(i) to (iii)	Rule on inducements
2.3.2R	Disclosure obligation
2.3.8G	Guidance on inducements

Modification of inducement rules specified in Table 2

- 18.8A.7 R (1) The *client's best interest rule* applies only in relation to the application of the inducement *rules* that Table 2 applies to an *OPS firm*.
- (2) In *COBS 2.3.1R(3)*, references to “*designated investment business*” and “*ancillary services*” are to be construed as references to *OPS activity*.

Record keeping: inducements

- 18.8A.8 R (1) If an *OPS firm* pays or accepts a fee, commission or other non-monetary benefit pursuant to:
- (a) *COBS 2.3.1R(2)*, it must:
- (i) hold evidence supporting its assessment that it was permissible to pay or accept the fee, commission or other non-monetary benefit; and
- (ii) make a record of the information disclosed to the *client* in accordance with *COBS 2.3.1R(2)(b)*;
- (b) *COBS 2.3A.12R(2)(b)*, it must hold evidence supporting its assessment that the benefit was an acceptable minor non-monetary benefit.
- (2) A *firm* must keep the evidence or record for at least five years from the date on which it was produced.
- (3) The evidence or record must 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:
- (a) the *FCA* is able to access it readily and to reconstitute each key stage of the processing of each transaction;
- (b) it is possible for any corrections or other amendments, and the contents of the records prior to such corrections or amendments, to easily be ascertained;
- (c) it is not possible for the records otherwise to be manipulated or altered;
- (d) it can be exploited through information technology or any other efficient method of exploitation when analysis of the data cannot easily be carried out due to the volume and nature of the data; and
- (e) the *firm's* arrangements comply with the record-keeping requirements irrespective of the technology used.

- 18.8A.9 G SYSC 9.1.1R (General requirements) contains general record-keeping requirements that apply to an *OPS firm*.

Inducements and research

- 18.8A.10 R The provisions in *COBS* 2.3B (Inducements and research) apply to an *OPS firm* with the following modifications:
- (1) *COBS* 2.3B.1R does not apply;
 - (2) for the *guidance* in *COBS* 2.3B.2G substitute the following *guidance*:

“(1) An *OPS firm* is prohibited from receiving inducements (other than acceptable minor non-monetary benefits) in relation to *OPS activity* falling within the scope of *COBS* 18.8A.4R. Compliance with *COBS* 2.3B (Inducements and research) allows such a *firm* to receive third party *research* (relating to *OPS activity* falling within the scope of *COBS* 18.8A.4R) without breaching the prohibition in *COBS* 2.3A.12R.

(2) An *OPS firm* may receive third party *research* in relation to *OPS activity* falling within the scope of *COBS* 18.8A.6R without subjecting that *research* to an assessment under the inducement *rule* in *COBS* 2.3A.1R if the *research* is acquired in accordance with *COBS* 2.3B as such *research* will not constitute an inducement.”;
 - (3) in relation to an *OPS firm* to which *COBS* 18.8A.4R applies, for the *guidance* in *COBS* 2.3B.22G substitute:

“An *OPS firm* should also consider whether the goods or services it is 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 inducement *rule* under *COBS* 2.3A.12R(2).”;
 - (4) in relation to an *OPS firm* to which *COBS* 18.8A.6R applies, *COBS* 2.3B.22G does not apply; and
 - (5) references to “*ancillary services*” and “*investment services*” (in *COBS* 2.3B.3R, *COBS* 2.3B.4R, and *COBS* 2.3B.5R) are to be construed as references to, as applicable, either:
 - (a) *OPS activity* that falls within the scope of *COBS* 18.8A.4R; or
 - (b) *OPS activity* that falls within the scope of *COBS* 18.8A.6R.

Record keeping: inducements and research

- 18.8A.11 R If an *OPS firm* receives *research* pursuant to *COBS* 2.3B.3R it must hold evidence to demonstrate compliance with that *rule*, including the requirements in *COBS* 2.3B.4R that must be met when *COBS* 2.3B.3R(2) applies.

Best execution

- 18.8A.12 R (1) An *OPS firm*, when executing an order in relation to a *financial instrument*, must comply with the provisions in *COBS 11.2A* (Best execution) that are applicable to a *firm* carrying on *MiFID business*, as if the *OPS firm* were carrying on *MiFID business*, and as modified by *COBS 18.8A.13R*.
- (2) The provisions in *COBS 11.2A* (Best execution) marked “EU” and *COBS 11 Annex 1EU* (Regulatory Technical Standard 28 (RTS 28)) apply to an *OPS firm* as if they were *rules*.

Modification of best execution rules

- 18.8A.13 R (1) In *COBS 11.2A.6R* the reference to the inducement requirements is to be construed as a reference to the requirements found in the inducement *rules* applied to an *OPS firm* pursuant to *COBS 18.8A.4R*.
- (2) In *COBS 11.2A.25EU*, the requirement to act in the best interests of a *client* only applies in relation to *OPS activity* that involves executing an order for an *OPS firm’s client*.
- (3) References to “*portfolio management*” are to be construed as references to *OPS activity*.

Client order handling

- 18.8A.14 R (1) When carrying out a *client order* an *OPS firm* must comply with the provisions in *COBS 11.3* (Client order handling), other than *COBS 11.3.1R(3)*, as modified by this *rule*.
- (2) References to “*financial instrument*” are to be construed as a reference to a *designated investment* (other than a *P2P agreement*).

Record keeping: client orders and transactions

- 18.8A.15 R The *rules* in *COBS 18 Annex 2* (Record keeping: client orders and transactions) apply to an *OPS firm*.

Personal account dealing

- 18.8A.16 R (1) An *OPS firm* must comply with the provisions in *COBS 11.7* (Personal account dealing), other than *COBS 11.7.2R(1)*, as applied and modified by this *rule*.
- (2) In *COBS 11.7.1R* the reference to “*designated investment business*” is to be construed as a reference to *OPS activity*.

Periodic reporting

- 18.8A.17 R (1) An *OPS firm* must apply the *rules* in *COBS 16.2* (Occasional reporting) and *COBS 16.3* (Periodic reporting) as modified by this

rule.

- (2) In *COBS* 16.2.6R (special cases) add the following paragraph after *COBS* 16.2.6R(3):

“(4) the *OPS firm* carries on *OPS activity* for an *occupational pension scheme* trustee who is a *professional client* and who is habitually resident in the *United Kingdom*. In this case, the *OPS firm* may rely upon the exceptions in *COBS* 16.2.1R(2) or *COBS* 16.2.6R(1) only if it provides a *periodic statement* to the *professional client* containing the information required by *COBS* 18.8A.17R(3).”.

- (3) Where an *OPS firm* conducts *OPS activity* and is obliged to provide a *periodic statement*, the *periodic statement* must contain the information in the table below.

Information to be included in a periodic statement provided by an OPS firm conducting OPS activity	
(1)	Investment objectives
	A statement of any investment objectives governing the mandate of the portfolio of the <i>occupational pension scheme</i> as at the closing and starting date of the <i>periodic statement</i> .
(2)	Details of any asset loaned or charged
	(a) A summary of any <i>investments</i> that were, at the closing date, lent to a third party and any <i>investments</i> that were at that date charged to secure borrowings made on behalf of the portfolio; and
	(b) the aggregate of any interest payments made and income received during the account period in respect of loans or borrowings made during that period and a comparison with the previous period.
(3)	Transactions and changes in composition
	(a) A summary of the <i>transactions</i> entered into for the portfolio during the period and a comparison with the previous period;
	(b) the aggregate of <i>money</i> and a summary of all <i>investments</i> transferred into and out of the portfolio during the period; and
	(c) the aggregate of any interest payments, dividends and other benefits received by the <i>firm</i> for the portfolio during that period and a comparison with the previous period.

(4)	Charges and remuneration	
	If not previously advised in writing, a statement for the period of account:	
	(a)	of the aggregate <i>charges</i> of the <i>firm</i> and its <i>associates</i> ; and
	(b)	of any <i>remuneration</i> received by the <i>firm</i> or its <i>associates</i> or both from a third party in respect of the <i>transactions</i> entered into, or any other services provided, for the portfolio.
(5)	Movement in the value of the portfolio	
	A statement of the difference between the value of the portfolio at the closing date of the period of account and its value at the starting date, having regard, during the period of account, to:	
	(a)	the aggregate of assets received from the <i>occupational pension scheme</i> and added to the portfolio;
	(b)	the aggregate of the value of assets transferred, or of amounts paid, to the <i>client</i> ;
	(c)	the aggregate income received on behalf of the <i>client</i> in respect of the portfolio; and
	(d)	the aggregate of realised and unrealised profits or gains and losses attributable to the assets comprised in the portfolio.

Annex D

Amendments to the Client Assets sourcebook (CASS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1 Application and general provisions

...

1.4 Application: particular activities

...

Auction regulation bidding

- 1.4.9 R ~~Where a *firm* carries on *auction regulation bidding* it may elect to comply with CASS (but not CASS 5) in respect of this activity, subject to the general modifications in CASS 1.4.10R. [deleted]~~
- 1.4.10 R ~~Where a *firm* has made an election in accordance with CASS 1.4.9R, CASS is modified so that in relation to that *firm*: [deleted]~~
- (1) ~~each reference to:~~
 - (a) ~~*designated investments*;~~
 - (b) ~~*safe custody assets*; and~~
 - (c) ~~*contingent liability investments*;~~

~~includes a reference to a *two-day emissions spot*;~~
 - (2) ~~each reference to *designated investment business* includes *auction regulation bidding*;~~
 - (3) ~~each reference to *safeguarding and administering investments*, including *safeguarding and administration of assets (without arranging)* and *arranging safeguarding and administration of assets*, includes those activities where they are carried on in relation to a *two-day emissions spot*; and~~
 - (4) ~~the reference in CASS 6.2.3AR to an '*emissions auction product* that is a *financial instrument*' includes a *two-day emissions spot*;~~
- 1.4.11 G ~~The effect of CASS 1.4.10R is that when a *firm* makes an election in accordance with CASS 1.4.9R: [deleted]~~
- (1) ~~a *two-day emissions spot* falls within the scope of each chapter in CASS (save for CASS 5), for example:~~

- (a) ~~the reference in CASS 6.1.1R(1)(b) to *safeguarding and administering investments* is modified to include the activity of safeguarding and administering a *two-day emissions spot*; and~~
 - (b) ~~any *money* that the *firm* receives or holds for or on behalf of a *client* in the course of or in connection with its *auction regulation bidding* activities will be treated as *client money* and so will need to be dealt with in accordance with the *client money rules*; and~~
- (2) ~~that election also has effect in relation to *rules and guidance* elsewhere in the *Handbook*, including:~~
- (a) ~~COBS 3 (Client categorisation);~~
 - (b) ~~COBS 6.1.7R (Information concerning safeguarding of designated investments belonging to clients and client money);~~
 - (c) ~~COBS 6.1.11R (Timing of disclosure);~~
 - (d) ~~COBS 16.4 (Statements of client designated investments or client money);~~
 - (e) ~~SUP 3 (Auditors);~~
 - (f) ~~SUP 10A.4.4R (the *table of controlled functions*) and SUP 10A.7.9R (CASS operational oversight function (CF10a));~~
 - (fa) ~~SUP 10 (Table of FCA controlled functions for relevant authorised persons), SYSC 5.2.30R (Table: FCA specified significant harm functions) and SYSC 5.2.32R (CASS oversight and the certification regime); and~~
 - (g) ~~SUP 16.14 (Client money and asset return).~~
- 1.4.12 G The option to elect to comply with CASS set out in CASS 1.4.9R only applies to the extent the *firm* is carrying on *auction regulation bidding*. Where a *firm* is carrying on *MiFID business bidding*, CASS applies to it in accordance with the general application *rules* in CASS for a *firm* that is carrying on *MiFID business*. [deleted]
- 1.4.13 R Where a *firm* makes an election in accordance with CASS 1.4.9R it must: [deleted]
- (1) ~~make a written record of the election, including the date from which the election is to be effective, on the date it makes the election;~~
 - (2) ~~keep that record from the date that it is made for a period of five years after ceasing to use the opt in.~~

- 1.4.14 R ~~Where a *firm* that has opted in to CASS under CASS 1.4.9R subsequently decides to cease its use of that opt in it must: [deleted]~~
- ~~(1) make a written record of this decision, including the date from which the decision is to be effective, on the date it takes the decision;~~
 - ~~(2) keep that record from the date that it is made for a period of five years after the date it is to be effective; and~~
 - ~~(3) discharge any outstanding fiduciary obligations that had arisen because the *firm* had elected to comply with CASS.~~

...

Sch 1 Record keeping requirements

...

1.3G

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...				
CASS 1.4.12R and, where applicable, CASS 1.4.13R	For a <i>firm</i> which carries on <i>auction regulation bidding</i> , election (under CASS 1.4.9R) to comply with CASS in respect of this activity and, where applicable, decision to discontinue use of that opt in	Record of this election or, where applicable, the decision to discontinue use of the opt in, including the date on which either is to be effective	Upon making the election or, where applicable, upon taking the decision to discontinue use of the opt in	5 years from the date on which the opt in ceases to be used [deleted]
...				

Annex E

Amendments to the Market Conduct Sourcebook (MAR)

In this Annex, underlining indicates new text.

10 Commodity derivative position limits and controls, and position reporting

...

10.4 Position reporting

Application

10.4.1 G The application of this section is set out in the following table:

Type of firm	Applicable provisions
<i>UK regulated market</i>	MAR 10.4.2G
<i>UK firm operating a multilateral trading facility or an OTF and a UK branch of a third country investment firm operating a multilateral trading facility or an OTF</i>	MAR 10.4.3R to MAR 10.4.6G
<i>UK MiFID investment firm</i>	MAR 10.4.7D to MAR 10.4.9D <u>and MAR 10.4.11G</u>
<i>UK branch of a third country investment firm when not operating a multilateral trading facility or an OTF</i>	MAR 10.4.7D to MAR 10.4.9D <u>and MAR 10.4.11G</u>
<i>Member, participant or a client of a UK trading venue</i>	MAR 10.4.7D
<i>EEA MiFID investment firm who is a member, participant or a client of a UK trading venue</i>	MAR 10.4.10D <u>to MAR 10.4.11G</u>

...

10.4.11 G (1) This guidance applies to persons subject to MAR 10.4.8D(2) or MAR 10.4.10D(3).

(2) A firm subject to MAR 10.4.8D(2) or MAR 10.4.10D(3) may use a third party technology provider to submit to the FCA the report referred to in MAR 10.4.8 D(2) provided that it does so in a manner consistent with

MiFID. It will retain responsibility for the completeness, accuracy and timely submission of the report and should populate field 5 of MiFID ITS 4 Annex II with its own reporting entity identification. It should be the applicant for, and should complete and sign, the FCA MDP on-boarding application form.

- (3) MAR 10.4.11.2G applies to a trading venue subject to MAR 10.4.
- (4) A firm subject to MAR 10.4.8D(2) or MAR 10.4.10D(3) may arrange for the trading venue where that commodity derivative or emission allowance is traded to provide the FCA with the report provided that it does so in a manner consistent with MiFID. The firm will retain responsibility for the completeness, accuracy and timely submission of the report, submitted on its behalf. The firm should populate field 5 of MiFID ITS 4 Annex II with its own reporting entity identification.

Annex F

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
...			
(7AA)	A firm that has exercised an opt in to CASS in accordance with CASS 1.4.9R	SUP 3.1 to SUP 3.7, SUP 3.11	SUP 3.1, SUP 3.2, SUP 3.8, SUP 3.10.
...			

...

10A FCA Approved Persons

10A.1 Application

...

Bidders in emissions auctions

10A.1.21 G For a *firm* that is exempt from *MiFID* under article 2(1)(j) and whose only *permission* is *bidding in emissions auctions*, the only *FCA controlled functions* that apply to it are:

...

- (2) the *money laundering reporting function*; and
- (3) the *customer function*; ~~and~~
- (4) ~~(where it has exercised an opt in to CASS in accordance with CASS~~

~~1.4.9R and is a CASS medium firm or a CASS large firm) the CASS operational oversight function. [deleted]~~

...

17A Transaction reporting and supply of reference data

...

17A.2 Connectivity with FCA systems

17A.2.1 R ...

17A.2.1A G The FCA expects a systematic internaliser that will be supplying the FCA with financial instrument reference data in respect of a financial instrument traded on its system that is not admitted to trading on a regulated market or traded on an MTF or OTF to establish a technology connection with the FCA for the supply of that reference data.

17A.2.1B G A firm in SUP 17A.1.1.R(4) may use a third party technology provider to submit to the FCA financial instrument reference data in respect of a financial instrument traded on its system provided that it does so in a manner consistent with MiFID and MiFIR. Firms will retain responsibility for the completeness, accuracy and timely submission of the data. A firm should be the applicant for, and should complete and sign, the FCA MDP on-boarding application form.

...

Annex G

Amendments to the Decision Procedure and Penalties manual (DEPP)

In this Annex, underlining indicates new text.

2 Statutory notices and the allocation of decision making

...

2.5 Provision for certain categories of decision

...

2.5.18 Some of the distinguishing features of notices given under enactments other than the *Act* are as follows:

...

- (4) The *FCA* is only required to give a single *supervisory notice* under Regulations 19 and 27 of the *MiFI Regulations*. No representations can be made to the *FCA* after the issuing of this notice, but the matter can be referred to the *Tribunal*.

...

2 Annex 1G Warning notices and decision notices under the Act and certain other enactments

...

The Small and Medium Sized Business (Finance Platforms) Regulations 2015	Description	Handbook reference	Decision maker
...			
<u>Markets in Financial Instruments Regulations 2017</u>	<u>Description</u>	<u>Handbook reference</u>	<u>Decision maker</u>
<u>Regulations 39(1)(a) and 40(1)(a)</u>	<u>when the <i>FCA</i> is proposing or deciding to publish a statement</u>		<u><i>RDC</i></u>

<u>Regulations 39(1)(b) and 40(1)(b)</u>	<u>when the FCA is proposing or deciding to impose a penalty</u>		<u>RDC</u>
--	--	--	------------

<u>Data Reporting Services Regulations 2017</u>	<u>Description</u>	<u>Handbook reference</u>	<u>Decision maker</u>
<u>Regulations 8(1) and 10(8)(a)</u>	<u>when the FCA is proposing to impose a restriction on the applicant for verification or authorisation</u>		<u>Executive procedures</u>
<u>Regulations 8(1) and 10(9)(a)</u>	<u>when the FCA is deciding to impose a restriction on the applicant for verification or authorisation</u>		<u>RDC or executive procedures</u> (see Note 1)
<u>Regulations 8(1) and 10(8)(b)</u>	<u>when the FCA is proposing to refuse an application for verification or authorisation</u>		<u>Executive procedures</u>
<u>Regulations 8(1) and 10(9)(b)</u>	<u>when the FCA is deciding to refuse an application for verification or authorisation</u>		<u>RDC or executive procedures</u> (see Note 2)
<u>Regulations 8(3), 11(4) and 11(5)(b)</u>	<u>when the FCA is proposing or deciding to cancel a verification or the authorisation of a data reporting services provider otherwise than at its request</u>		<u>RDC</u>
<u>Regulations 8(4) and 12(3)</u>	<u>when the FCA is proposing to refuse a request to vary a verification or the authorisation of a data reporting services provider</u>		<u>Executive procedures</u>
<u>Regulations 8(4) and 12(4)</u>	<u>when the FCA is deciding to refuse a request to vary a verification or the authorisation of a data reporting services provider</u>		<u>RDC or executive procedures</u> (see Note 1)
<u>Regulation 11(4)</u>	<u>when the FCA is proposing to refuse a request to cancel the</u>		<u>Executive procedures</u>

	<u>authorisation of a <i>data reporting services provider</i></u>		
<u>Regulation 11(5)(b)</u>	<u>when the <i>FCA</i> is deciding to refuse a request to cancel the authorisation of a <i>data reporting services provider</i></u>		<u><i>RDC</i> or <i>executive procedures</i></u> (see Note 2)
<u>Regulations 43(1)(a) and 44(1)(a)</u>	<u>when the <i>FCA</i> is proposing or deciding to publish a statement</u>		<u><i>RDC</i></u>
<u>Regulations 43(1)(b) and 44(1)(b)</u>	<u>when the <i>FCA</i> is proposing or deciding to impose a financial penalty</u>		<u><i>RDC</i></u>
<u>Regulations 43(1)(c) and 44(1)(c)</u>	<u>when the <i>FCA</i> is proposing or deciding to require restitutions to be paid</u>		<u><i>RDC</i></u>
<p><u>Notes:</u></p> <p>1) If representations are made in response to a <i>warning notice</i>, then the <i>RDC</i> will take the decision to give a <i>decision notice</i> if the action proposed involves:</p> <p><u>(a) restricting a <i>person</i> from providing a <i>data reporting service</i>; or</u></p> <p><u>(b) refusing an application to include a type of activity in a verification or authorisation.</u></p> <p><u>In all other cases, the decision to give a <i>decision notice</i> will be taken by <i>FCA</i> staff under <i>executive procedures</i>.</u></p> <p>2) If representations are made in response to a <i>warning notice</i> then the <i>RDC</i> will take the decision to give a <i>decision notice</i>. Otherwise the decision to give a <i>decision notice</i> will be taken by <i>FCA</i> staff under <i>executive procedures</i>.</p>			

2 Annex 2G Supervisory notices

...

The Payment Accounts Regulations 2015	Description	Handbook reference	Decision maker
...			
<u>Markets in Financial Instruments Regulations 2017</u>	<u>Description</u>	<u>Handbook reference</u>	<u>Decision maker</u>

<u>Regulation 19(4)</u>	<u>when the FCA is imposing a limitation, restriction or requirement under regulation 19</u>		<u>Executive procedures</u> (see <u>DEPP 2.5.18</u>)
<u>Regulation 27(4)</u>	<u>when the FCA is imposing a requirement under regulation 27</u>		<u>Executive procedures</u> (see <u>DEPP 2.5.18</u>)
<u>Regulations 31(3) and 31(6)</u>	<u>when the FCA proposes or decides to impose a requirement, or decides to not rescind the imposition of a requirement that has already taken effect under regulation 31</u>		<u>RDC</u>

<u>Data Reporting Services Regulations 2017</u>	<u>Description</u>	<u>Handbook reference</u>	<u>Decision maker</u>
<u>Regulation 34(6)</u>	<u>when the FCA is imposing a limitation or other restriction under regulation 34</u>		<u>RDC or executive procedures</u> (see Note)
<u>The RDC will take the decision to give a notice imposing a restriction or limitation if it involves restricting a person from providing a data reporting service. Otherwise the decision to give a notice will be taken by FCA staff under executive procedures.</u>			

Sch 4 Powers Exercised

...

4.2G

The following additional powers and related provision have been exercised by the FCA to make the statements of policy in <i>DEPP</i> :
...
Regulation 29 (Application of Part 26 of the 2000 Act) of the <i>Immigration</i>

<i>Regulations</i>
<u>Regulation 35 (Guidance) of the <i>MiFI Regulations</i></u>
<u>Regulation 41 (Statements of Policy) of the <i>MiFI Regulations</i></u>
<u>Regulation 50 (Application of Part 26 of the Act) of the <i>MiFI Regulations</i></u>
<u>Regulation 22 (Guidance) of the <i>DRS Regulations</i></u>
<u>Regulation 48 (Statements of Policy) of the <i>DRS Regulations</i></u>
<u>Regulation 49 (Application of Part 26 of the Act) of the <i>DRS Regulations</i></u>

Annex H

Amendments to the Enforcement Guide (EG)

Insert the following new text after EG 19.33 (The Small and Medium Sized Business (Finance Platforms) Regulations 2015). All the text is new and is not underlined.

19 Non-FSMA powers

...

19.34 Markets in Financial Instruments Regulations 2017

- 19.34.1 The *MiFI Regulations* in part implement *MiFID*. The *FCA* has investigative and enforcement powers in relation to both criminal and civil breaches of the *MiFI Regulations*. The *MiFI Regulations* impose requirements on:
- (1) *persons* holding positions in relevant contracts for commodity derivatives trading on *trading venues* and for *economically equivalent OTC contracts*, whether or not the *persons* are authorised; and
 - (2) exempt *investment firms* providing services in *algorithmic trading*, *direct electronic access* or acting as a general clearing member or in relation to the synchronisation of business clocks.
- 19.34.2 The *FCA's* approach to enforcing the *MiFI Regulations*, whether the *person* is authorised or not, will mirror our general approach to enforcing the *Act*, as set out in *EG 2*. We will seek to exercise our enforcement powers in a manner that is transparent, proportionate, responsive to the issue and consistent with our publicly stated policies. We will also seek to ensure fair treatment when exercising our enforcement powers. Finally, we will aim to change the behaviour of the *person* who is the subject of our action, to deter future non-compliance by others, to eliminate any financial gain or benefit from non-compliance and, where appropriate, to remedy the harm caused by the non-compliance.
- 19.34.3 The regulatory powers which the *MiFI Regulations* provide to the *FCA* include:
- (1) the power to require information and appoint investigators;
 - (2) powers of entry and inspection;
 - (3) the power to publicly censure;
 - (4) the power to impose financial penalties;
 - (5) the power to apply for an injunction or restitution order;
 - (6) the power to require restitution;

- (7) the power to impose limitation, restriction or requirement; and
- (8) the power to prosecute relevant offences.

19.34.4 In addition, the *MiFI Regulations* provide the power to require the removal of persons from the management board of an *investment firm*, *credit institution* or *recognised investment exchange*. This is a supervisory power, rather than a disciplinary one, and it may be exercised whenever the *FCA* deems it necessary for the purpose of any of our functions under *MiFID* or *MiFIR*.

19.34.5 The *MiFI Regulations*, for the most part, mirror the *FCA's* investigative, sanctioning and regulatory powers under the *Act*. The *FCA* has decided to adopt procedures and policies in relation to the use of those powers akin to those we have under the *Act*. Key features of the *FCA's* approach are described below.

The conduct of investigations under the MiFI Regulations

19.34.6 The *MiFI Regulations* apply much of Part 11 of the *Act*. The effect of this is to apply the same procedures under the *Act* for appointing investigators and requiring information when investigating breaches of the *MiFI Regulations*.

19.34.7 The *FCA* will notify the subject of the investigation that we have appointed investigators to carry out an investigation under the *MiFI Regulations* and the reasons for the appointment, unless notification is likely to prejudice the investigation or otherwise result in it being frustrated. The *FCA* expects to carry out a scoping visit early on in the enforcement process in most cases. The *FCA's* policy in civil investigations under the *MiFI Regulations* is to use powers to compel the provision of information in the same way as we would in the course of an investigation under the *Act*.

Decision making under the MiFI Regulations

19.34.8 The decision making procedure for those decisions under the *MiFI Regulations* requiring the giving of a *warning notice*, *decision notice* or a *supervisory notice* are dealt with in *DEPP*.

19.34.9 The *MiFI Regulations* do not require the *FCA* to have published procedures for commencing criminal prosecutions. However, in these situations the *FCA* expects that we will normally follow our decision making procedures for the equivalent decisions under the *Act*, as set out in *EG 12*.

19.34.10 The *MiFI Regulations* do not require the *FCA* to have published procedures to apply to the court for an *injunction* or restitution order. However, the *FCA* will normally follow our decision making procedures for the equivalent decisions under the *Act*, as set out in *EG 10* and *EG 11*.

19.34.11 The *MiFI Regulations* require the *FCA* to give third party rights as set out in section 393 of the *Act* and to give access to certain material as set out in section 394 of the *Act*.

19.34.12 Certain *FCA* decisions (for example a requirement to reduce the size of a position,

publication of a statement and the imposition of a penalty) may be referred to the *Tribunal* by an aggrieved party.

Imposition of penalties under the MiFI Regulations

- 19.34.13 When determining whether to take action to impose a penalty or to issue a public censure under the *MiFI Regulations* the *FCA*'s policy includes having regard to the relevant factors in *DEPP* 6.2 and *DEPP* 6.4. The *FCA*'s policy in relation to determining the level of a financial penalty includes having regard, where relevant, to *DEPP* 6.5 to *DEPP* 6.5D.
- 19.34.14 As with cases under the *Act*, the *FCA* may settle or mediate appropriate cases involving civil breaches of the *MiFI Regulations* to assist us to exercise our functions under the *MiFI Regulations* in the most efficient and economic way. See *DEPP* 5, *DEPP* 6.7 and *EG* 5 for further information on the settlement process and the *settlement discount scheme*.
- 19.34.15 The *FCA* will apply the approach to publicity that is outlined in *EG* 6, read in light of the applicable publicity provisions in section 391D of the *Act*.

Removal of persons from management boards under the MiFI Regulations

- 19.34.16 The power under Part 5 of the *MiFI Regulations* to remove a person from a management board may be used in respect of an *investment firm*, *credit institution* or *recognised investment exchange*.
- 19.34.17 This power may be used where the *FCA* considers that the removal is necessary for the purpose of exercising functions under *MiFID* or *MiFIR*. Examples of where this power may be used include, but are not limited to, ensuring that all members of the management body:
- (1) are of sufficiently good repute;
 - (2) possess sufficient knowledge, skills and experience to perform their duties;
 - (3) commit sufficient time to perform their functions;
 - (4) do not hold too many directorships;
 - (5) act with honesty, integrity and independence of mind; and
 - (6) have no conflicts of interest.
- 19.34.18 The *FCA* will have regard to all relevant circumstances, on a case-by-case basis, taking into account the specific circumstances of the *investment firm*, *credit institution* or *recognised investment exchange* and the member of the management board. The *FCA* will exercise this power fairly and proportionately.
- 19.34.19 It should be noted that, while the *FCA* will have regard to the range of regulatory tools at its disposal, we are not required to exhaust all other options before imposing the requirement to remove.

- 19.34.20 The *FCA* will take into account all relevant circumstances when considering whether to require the removal to occur immediately or on a specified date.

Statement of policy in section 169(7) (as implemented by the MiFI Regulations)

- 19.34.21 The *MiFI Regulations* apply section 169 of the *Act* which requires the *FCA* to publish a statement of policy on the conduct of certain interviews in response to requests from overseas regulators. For the purposes of the *MiFI Regulations* the *FCA* will follow the procedures described in *DEPP 7*.

19.35 Data Reporting Services Regulations 2017

- 19.35.1 The *DRS Regulations* in part implement *MiFID*. The *FCA* has investigation and enforcement powers in relation to both criminal and civil breaches of the *DRS Regulations*. The *DRS Regulations* impose requirements on *data reporting services providers* (“DRSPs”) which are entities authorised to provide services of:

- (1) publishing trade reports (“*APA*”);
- (2) reporting details of transactions (“*ARM*”); and
- (3) collecting trade reports (“*CTP*”).

- 19.35.2 The *FCA*'s approach to enforcing the *DRS Regulations* will mirror our general approach to enforcing the *Act*, as set out in *EG 2*. We will seek to exercise our enforcement powers in a manner that is transparent, proportionate, responsive to the issue, and consistent with our publicly stated policies. We will also seek to ensure fair treatment when exercising our enforcement powers. Finally, we will aim to change the behaviour of the *person* who is the subject of our action, to deter future non-compliance by others, to eliminate any financial gain or benefit from non-compliance, and where appropriate, to remedy the harm caused by the non-compliance.

- 19.35.3 The regulatory powers which the *DRS Regulations* provide to the *FCA* include:

- (1) the power to require information and appoint investigators;
- (2) powers of entry and inspection;
- (3) the power of public censure;
- (4) the power to impose financial penalties;
- (5) the power to impose a limitation or other restrictions;
- (6) the power to apply for an *injunction*;
- (7) the power to require restitution; and
- (8) the power to prosecute unauthorised providers.

- 19.35.4 In addition, the *DRS Regulations* also provide the power for the *FCA* to take criminal or civil action for misleading the *FCA*.
- 19.35.5 The *DRS Regulations*, for the most part, mirror the *FCA's* investigative, sanctioning and regulatory powers under the *Act*. The *FCA* has decided to adopt procedures and policies in relation to the use of those powers akin to those we have under the *Act*. Key features of the *FCA's* approach are described below.

The conduct of investigations under the *DRS Regulations*

- 19.35.6 The *DRS Regulations* apply much of Part 11 of the *Act*. The effect of this is to apply the same procedures under the *Act* for appointing investigators and requiring information when investigating breaches of the *DRS Regulations*.
- 19.35.7 The *FCA* will notify the subject of the investigation that we have appointed investigators to carry out an investigation under the *DRS Regulations* and the reasons for the appointment, unless notification is likely to prejudice the investigation or otherwise result in it being frustrated. The *FCA* expects to carry out a scoping visit early on in the enforcement process in most cases. The *FCA's* policy in civil investigations under the *DRS Regulations* is to use powers to compel the provision of information in the same way as we would in the course of an investigation under the *Act*.

Decision making under the *DRS Regulations*

- 19.35.8 The decision making procedure for those decisions under the *DRS Regulations* requiring the giving of a *warning notice*, *decision notice* or a *supervisory notice* are dealt with in *DEPP*.
- 19.35.9 For decisions made by *executive procedures* the procedures to be followed will be those described in *DEPP* 4.
- 19.35.10 The *DRS Regulations* do not require the *FCA* to have published procedures for commencing criminal prosecutions. However, in these situations the *FCA* expects that we will normally follow our decision making procedures for the equivalent decisions under the *Act*, as set out in *EG* 12.
- 19.35.11 The *DRS Regulations* do not require the *FCA* to have published procedures to apply to the court for an *injunction* or restitution order. However, the *FCA* will normally follow our decision making procedure for the equivalent decisions under the *Act*, as set out in *EG* 10 and *EG* 11.
- 19.35.12 The *DRS Regulations* require the *FCA* to give third party rights as set out in section 393 of the *Act* and to give access to certain material as set out in section 394 of the *Act*.
- 19.35.13 Certain *FCA* decisions (for example the publication of a statement and the imposition of a penalty) may be referred to the *Tribunal* by an aggrieved party.

Imposition of penalties under the *DRS Regulations*

- 19.35.14 When determining whether to take action to impose a penalty or to issue a public censure under the *DRS Regulations* the *FCA's* policy includes having regard to the relevant factors in *DEPP 6.2* and *DEPP 6.4*. The *FCA's* policy in relation to determining the level of a financial penalty includes having regard, where relevant, to *DEPP 6.5* to *DEPP 6.5D*.
- 19.35.15 As with cases under the *Act*, the *FCA* may settle or mediate appropriate cases involving civil breaches of the *DRS Regulations* to assist us to exercise our functions under the *DRS Regulations* in the most efficient and economic way. See *DEPP 5*, *DEPP 6.7* and *EG 5* for further information on the settlement process and the *settlement discount scheme*.
- 19.35.16 The *FCA* will apply the approach to publicity that is outlined in *EG 6*, read in light of applicable publicity provisions in section 391D of the *Act*.
- Statement of policy in section 169(7) (as implemented by the *DRS Regulations*)
- 19.35.17 The *DRS Regulations* apply section 169 of the *Act* which requires the *FCA* to publish a statement of policy on the conduct of certain interviews in response to requests from overseas regulators. For the purposes of the *DRS Regulations* the *FCA* will follow the procedures described in *DEPP 7*.



PUB REF: 005403

© Financial Conduct Authority 2017
25 The North Colonnade Canary Wharf
London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk
All rights reserved