



HM Treasury

# **Transposition of the Markets in Financial Instruments Directive II:**

**response to the consultation**

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February 2017





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# 1 Introduction

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**1.1** The Treasury published a consultation on the transposition of Directive 2014/65/EU on Markets in Financial Instruments (MiFID II) on 27 March 2015<sup>1</sup>. The consultation closed on 18 June 2015. This document gives a summary of the responses submitted and the government's response to the consultation.

**1.2** MiFID II and Regulation (EU) 600/2014 on Markets in Financial Instruments (MiFIR) will replace the current MiFID (2004/39/EC) framework. They will lead to changes in market structure, the transparency regime for the trading of financial instruments, commodity derivative markets, reporting of transactions to regulators, investor protection and supervisory practices and powers.

**1.3** MiFID II and MiFIR were approved by the European Parliament on 15 April 2014 and by the European Council on 13 May 2014. They were subsequently published in the Official Journal of the EU on the 12 June 2014 and came into force on 2 July 2014.

**1.4** Since the consultation was published, the European Commission adopted a proposal on 10 February 2016 to delay the application of MiFID II and MiFIR by one year to 3 January 2018 and the transposition deadline for MiFID II also by one year to 3 July 2017. This provides additional time for implementation by member states, regulators and market participants. The directive amending MiFID II and the regulation amending MiFIR were published in the Official Journal of the EU on 30 June 2016<sup>2</sup>.

**1.5** The government set out its approach to transposition in the consultation document. In addition to a request for comments on the draft secondary legislation and impact assessment provided in the annexes to the consultation, the government sought comments on its approach to certain policy areas.

**1.6** This document sets out the government's response. Since the consultation, a number of further issues in MiFID II requiring legislative amendments as part of transposition have been identified. These have been included in the updated draft statutory instruments provided in the annexes to this document and further detailed in the relevant chapters throughout.

**1.7** Three updated draft statutory instruments are set out in the annexes to this document, which give effect to the approach to transposition set out in this document:

- the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017, referred to in this response document as the "Main Regulations"
- the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2017
- the Data Reporting Services Regulations 2017, referred to in this response document as the "Data Reporting Regulations"<sup>3</sup>

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<sup>1</sup> <https://www.gov.uk/government/consultations/transposition-of-the-markets-in-financial-instruments-directive-ii>

<sup>2</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ:L:2016:175:TOC>

<sup>3</sup> At the time of consultation, the "Main Regulations" were referred to as the "FSMA Regulations 2016". The annexes to the consultation also included the draft Financial Services and Markets Act 2000 (Qualifying EU Provisions) (Amendment) Order 2016 which has now been incorporated into the Main Regulations and the draft amendment on binary options which has now been incorporated into the amendments to the RAO.

**1.8** The Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) are in the process of consulting on the necessary changes to their rules to transpose MiFID II and to implement MiFIR.

**1.9** The government will make and lay the finalised statutory instruments in early 2017. Further technical refinements will be made to the updated draft statutory instruments provided in the annexes to this document before they are finalised. Once they come into force, market participants will be able to apply formally to the FCA<sup>4</sup> or PRA for new authorisations or variations of permission where necessary. The statutory instruments will come into force in the early part of 2017 to allow such applications, but the obligations in MiFID II and MiFIR will apply generally from 3 January 2018.

**1.10** The Commission is in the process of adopting various delegated and implementing acts (including regulatory and implementing technical standards) under MiFID II and MiFIR. These specify in greater detail how specific provisions of MiFID II and MiFIR operate. The government will consider whether further legislation is required in order to complete the transposition of MiFID II and the implementation of MiFIR.

**1.11** On 23 June, the EU referendum took place and the people of the United Kingdom voted to leave the European Union. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU membership remain in force. During this period the government will continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in future once the UK has left the EU.

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<sup>4</sup> On 13 January 2017 the FCA published their Application and Notification User Guide. The user guide also indicated that the FCA will accept draft applications for authorisation from early 2017. Further information can be found at: <https://www.fca.org.uk/publication/documents/mifid-ii-application-notification-guide.pdf>



## 2 Third countries

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**2.1** MiFID II permits member states to choose whether they require a third country firm to establish a branch in their jurisdiction when they provide MiFID investment services and activities to retail or elective professional clients. If the UK chooses to opt into this regime, it would replace the existing national regime which allows but does not require the establishment of a branch. The government consulted on the basis of retaining the current regime insofar as it is permitted by MiFID II.

**Question 1. Do you agree that the UK should maintain its current third country regime and not implement Article 39 MiFID II? Please explain your reasons why and supply any evidence that you have to support your answer.**

If you do not agree, please provide your views on:

- a) What would be the likely or expected economic and non-economic consequences of implementing the MiFID II third country regime?
- b) What impact would the implementation of Article 39 MiFID II have in relation to retail cross-border business currently conducted under applicable exclusions?

Please supply any evidence that you have to support your answers.

**2.2** Respondents almost unanimously agreed with the government's proposal to maintain the current third country regime and not opt into Article 39 MiFID II.

**2.3** Many respondents noted the benefits of the overseas person exclusion in allowing non-EEA firms access to UK financial markets, particularly through the exclusions for activities carried on "with or through" an authorised or exempt UK person. It was argued that this supports consumer choice and enhances competition. Respondents agreed that the current UK regime appropriately balances investor protection with being open to business internationally.

**2.4** A number of respondents asked that the Treasury keep the decision to not opt into Article 39 under review.

**2.5** Some respondents disagreed with the view expressed in the consultation that branches authorised under national regimes, rather than Article 39 MiFID II, would not be able to provide services to clients in other member states after an equivalence decision where the firm operating the branch was registered with the European Securities and Markets Authority (ESMA).

**2.6** The government welcomes the responses received in relation to this question. As set out in the consultation, the government's view is that the current regime has the virtue of being sufficiently tailored to client types and to the risks in question, and balances the need to maintain investor protection, market integrity and financial stability, while remaining open to business internationally. The government will therefore maintain the current third country regime and not implement Article 39 MiFID II.

**2.7** Even where the UK maintains its current approach a number of consequential changes to legislation are still required. In particular, changes are needed to enable, firstly, an Article 39 MiFID II branch in another member state, and secondly, a third country firm registered with ESMA, to navigate the general prohibition so that they can provide services to UK clients. These amendments are included in the updated draft statutory instruments in the annex.



## 3 Data reporting services

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**3.1** MiFID II introduces authorisation requirements for three specific data reporting services (DRSs). These are: Approved Reporting Mechanisms (ARMs), which report investment firms' relevant transactions to the FCA; Approved Publication Arrangements (APAs), which make public the relevant transactions of investment firms; and Consolidated Tape Providers (CTPs), which collect the trade reports for financial instruments from trading venues and APAs, and consolidate them into a continuous electronic live data stream providing price and volume data for each financial instrument. The government proposed to create a specific regime for Data Reporting Service Providers (DRSPs), rather than including them as regulated activities under the Financial Services and Markets Act's (FSMA) Regulated Activities Order (RAO).

**Question 2. Do you agree that it is appropriate and proportionate to create a separate regulation for DRSs and in particular to not include them as regulated activities under the RAO?**

**3.2** The majority of respondents agreed with the proposals to create a standalone regulation for DRSs. A number of respondents noted the benefits of standardisation in this approach across the European Economic Area.

**3.3** The government welcomes the comments received in relation to this question and will maintain its proposal to create a standalone regime for DRSPs in relation to the obligations placed on member states under Article 59(1) MiFID II. The government considers this to be appropriate in light of the inherent difference between activities carried out by DRSPs and activities carried out under the RAO.

**Question 3. Do you agree with the general approach to the implementation of Title V MiFID II, including copying out the definitions in respect of CTPs, ARMs and APAs? If not, please suggest an alternative, such as, following the structure of the 'investment firm' definition.**

**3.4** Respondents agreed that, as noted in the consultation, the definitions set out in MiFID II in respect of CTPs, ARMs and APAs are circular in nature and may create uncertainty. However, respondents were of the view that a copy out approach could reduce the risk of transposing these obligations in a way which is inconsistent with MiFID II or the approach taken by other member states.

**3.5** A number of respondents commented specifically on the difficulties in relation to the CTP definition, and the uncertainty around the level of consolidation undertaken before authorisation is required.

**3.6** The government will maintain a direct copy out approach in relation to the definitions of CTPs, ARMs and APAs. To reduce the element of circularity identified in the consultation, the government has amended the definition of "data reporting service" to refer directly to the services.

**3.7** In relation to the specific comments received around the definition of a CTP, following discussions at an EU level, the government has no reason to believe that the approach set out in the consultation in relation to the CTP obligations is not the right way to interpret the legislation. As such, the government maintains the view that a data reporting service which provides trade data with respect to 100% of equity and equity-like instruments traded on all trading venues is a CTP. Entities providing a consolidated tape for 100% of trading all equity

and equity-like instruments must therefore obtain authorisation under regulation 7 (which was previously regulation 5) in the Data Reporting Regulations (DRRs).

**Question 4. Do you consider that it is reasonable and proportionate to apply something akin to Section 89 and Section 90 Financial Services Act 2012 to a DRSP? If you do not consider it reasonable or proportionate please specify why.**

**3.8** The government received mixed responses to this question.

**3.9** A number of respondents felt that it would be reasonable and proportionate to create offences akin to Sections 89 and 90 of the Financial Services Act (FSA) 2012 specifically covering market manipulation in the DRRs.

**3.10** In the view of other respondents, it would be disproportionate to apply these offences in respect of the DRRs. Broadly, two reasons were given. First, that similar powers are provided for elsewhere in the DRRs or in existing regimes such as Part 8 FSMA<sup>1</sup> which allows the FCA to impose civil penalties and other sanctions for market manipulation. Second, that DRSPs do not originate data and would not be in a position to judge possible omissions or errors.

**3.11** The government has carefully considered whether it is proportionate to create offences akin to Sections 89 and 90 of the FSA 2012 in relation to market manipulation by DRSPs. On balance, the government agrees that it would not be proportionate to create new offences in this respect.

**3.12** The government notes that Sections 89 and 90 of the FSA 2012 will already apply to misleading statements or impressions made or given by DRSPs (for example, when reporting or publishing trades of financial instruments) in order to mislead market participants into buying or selling these instruments.

**3.13** Part 8 FSMA will also enable the FCA to impose financial penalties and other sanctions for market manipulation concerning MiFID II financial instruments which are traded on regulated markets, multilateral trading facilities and an organised trading facility, or whose price is linked to such instruments (this being conduct prohibited by Regulation (EU) No 596/2014).

**3.14** In addition, the DRRs themselves already capture misleading statements made to the competent authority.

**3.15** The government considers that these powers are sufficient to capture potential conflicts of interest which may arise where a DRSP engages in more than one type of DRS or carries out other functions such as operating an investment firm.

**Question 5. Do you agree with the transposition of the FCA powers in the DRRs? Do you consider that any further powers are necessary?**

**3.16** Respondents broadly agreed with the proposed transposition of FCA powers in the DRRs. However, one respondent considered that providing for these powers in respect of DRSPs would be disproportionate to the level of oversight that this type of activity requires. Another respondent sought clarity over whether the FCA would be given specific competition

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<sup>1</sup> At the time of the consultation, Part 8 FSMA (supplemented by the FCA Handbook) implemented the United Kingdom's obligations under the EU Market Abuse Directive 2003 (EU MAD). In July 2016 Part 8 (along with other parts of FSMA and other UK legislation) was substantially amended to implement Regulation (EU) No 596/2014, which repealed and replaced EU MAD.

powers to ensure that data reporting services are provided on a “reasonable commercial basis”.

**3.17** Article 69 MiFID II requires Member States to provide national competent authorities with the necessary powers to fulfil their duties under MiFID II and MiFIR. The government considers that the powers outlined in the consultation are necessary in order for the FCA to require information and undertake investigations, and therefore also necessary for them to fulfil their duties in accordance with Article 59(1) MiFID II. On this basis, the government will legislate to provide for these powers in the DRRs. Before the statutory instruments are laid, the drafting of the enforcement powers in the DRRs will be aligned with the drafting in the Main Regulations where appropriate.

**3.18** The government does not intend to provide the FCA with specific competition powers in relation to the provision of DRSs on a reasonable commercial basis. The government notes that the recently adopted delegated regulation<sup>2</sup> specifies the conditions that an APA and CTP must fulfil in order to be deemed to provide such services on a reasonable commercial basis. The delegated regulation also states that data providers should make public information concerning their fees and cost accounting methodologies used to determine their costs.

### Further comments

**3.19** Respondents also made a number of other comments.

**3.20** Two respondents questioned the 5pm deadline of the next working day in regulation 15 of the consultation stage DRRs for ARMs to report the information required by Article 26 MiFIR. The requirement in Article 26 is for ARMs to report transactions “as quickly as possible, and no later than the close of the following working day.”

**3.21** The government accepts that 5pm is not the close of the working day for all markets. The DRRs have therefore been amended to reflect that an ARM should have adequate policies and arrangements in place to provide the service to an investment firm of reporting the information specified by Article 26 MiFIR as quickly as possible, and no later than 11.59pm of the next working day following the transaction.

**3.22** One respondent sought clarity over whether an investment firms and Recognised Investment Exchanges (RIEs) would need additional permissions to provide DRSs.

**3.23** The government can confirm that RIEs and investment firms and credit institutions operating trading venues can provide DRSs separately under the DRRs. This would be in addition to their status as a recognised body under Part XVIII FSMA or their Part 4A permissions under FSMA.

**3.24** Two respondents noted that central securities depositories authorised under the Central Securities Depositories Regulation (CSDR)<sup>3</sup> should be exempt from authorisation under MiFID II if they provide the service of an ARM. In their view, this service falls under Annex B of CSDR.

**3.25** The government will respond to this issue in the response to the consultation on the implementation of CSDR<sup>4</sup>.

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<sup>2</sup> [http://ec.europa.eu/finance/securities/docs/isd/mifid/160425-delegated-regulation\\_en.pdf](http://ec.europa.eu/finance/securities/docs/isd/mifid/160425-delegated-regulation_en.pdf)

<sup>3</sup> [http://ec.europa.eu/finance/financial-markets/central\\_securities\\_depositories/index\\_en.htm](http://ec.europa.eu/finance/financial-markets/central_securities_depositories/index_en.htm)

<sup>4</sup> <https://www.gov.uk/government/consultations/consultation-on-the-implementation-of-the-central-securities-depositories-regulation-csdr/consultation-on-implementing-csdr>



# 4 Position limits and reporting

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**4.1** MiFID II requires that national competent authorities establish the maximum size of net position that a person may hold in commodity derivatives traded on trading venues and economically equivalent OTC contracts according to a methodology set out in the Regulatory Technical Standards (RTS) relating to position limits<sup>1</sup>. Positions held by non-financial entities in order to reduce risks directly relating to their commercial activity may be excluded from these limits. The government proposed to transpose the position limits regime through Parts 3 and 5 of the consultation stage Main Regulations<sup>2</sup>. The FCA were provided with the power to intervene in order to enforce position limits, either by limiting the ability of a person to enter into a commodity derivative, or by requiring them to reduce the size of the position held.

**4.2** Trading venues must also have position management powers under the directive. They will be required to monitor the size of positions, to be able to require a person to terminate or reduce their position, and to be able to require a person to provide liquidity back to the market in order to mitigate the effects of a large position. They will also be required to provide to the FCA a complete breakdown of the positions held by all persons on their trading venue, and to make public a weekly report with the aggregate position held by different categories of person. Investment firms which trade outside of a trading venue in economically equivalent contracts will be required to provide reports of the positions in commodity derivatives held by their clients, or clients of clients. The government consulted on transposing the position reporting and position management requirements through amendments to the Recognition Requirement Regulations for RIEs, and through FCA rules for investment firms and credit institutions.

**Question 6. Do you agree that the regulation adequately transposes the position limits regime established by Article 57 of MiFID II?**

**4.3** Respondents generally agreed that the regulations adequately transposed the position limits regime established by Article 57 MiFID II but asked that a number of detailed comments be reflected in the regulations.

**4.4** This included points relating to the scope of the regulations. One respondent questioned the persons to whom the position limit regime applies based on Article 1(6) MiFID. They argued this limits the application of the regime to authorised investment firms and credit institutions, and persons carrying out investment services and activities on a professional basis but who are exempt by virtue of Article 2 MiFID II.

**4.5** Another respondent raised a concern that regulation 6(1)(a) in the consultation stage Main Regulations referenced contracts traded “only” on a UK trading venue. The respondent asked whether the reference to contracts traded “only” on a UK trading venue would therefore exclude contracts traded on a UK trading venue and on a third country market.

**4.6** Other comments received asked that the government require the FCA to publish information about the deliverable supply, open interest and sources of information used

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<sup>1</sup> The regulatory technical standards relating to position limits were recently adopted by the Commission and can be found at: [http://ec.europa.eu/finance/securities/docs/isd/mifid/rts/161201-rts-21\\_en.pdf](http://ec.europa.eu/finance/securities/docs/isd/mifid/rts/161201-rts-21_en.pdf)

<sup>2</sup> Now Parts 3 and 6 of the Main Regulations.

when setting position limits. Similarly, one respondent asked that the government requires the FCA to publish a reason for setting a position limit against an ESMA opinion.

**4.7** More generally, two respondents noted that the regulations did not provide for applications to be made to the FCA in relation to positions held by or on behalf of non-financial entities in accordance with Article 57(12)(f) MiFID II and the RTS relating to position limits.

**4.8** The government considers that the regulations properly give effect to the position limit regime as established by Article 57 MiFID II. As such, the government is of the view that MiFID II is clear that the position limit regime applies to all persons holding positions in contracts covered by regulation 6(1)(a) and (b) (which is now regulation 14), unless a persons' positions are exempt by virtue of the second subparagraph of Article 57(1) MiFID II.

**4.9** The government notes the concern raised in relation to regulation 6(1)(a), which refers to contracts traded "only" on a UK trading venue. In order to avoid any doubt as to whether or not the regulation would exclude contracts traded on a UK trading venue and on a third country market, regulation 6(1), which is now regulation 14, has been redrafted so as to follow a more direct copy out approach to MiFID II.

**4.10** The government is clear that the scope of the position limits regime remains the same as in the consultation stage Main Regulations.

**4.11** The government welcomes the responses received regarding the regulations not providing the ability for the FCA to receive applications from or on behalf of non-financial entities. Regulation 18 now provides for such applications to be taken.

**4.12** In relation to the FCA publishing information on setting position limits, the government considers that MiFID II sets out a detailed process for national competent authorities to follow when establishing position limits. This includes the requirement, implemented in regulation 15(8), that the FCA publish a notice on its website explaining the reasons for not modifying a position limit following an ESMA opinion recommending that the limit be changed. The government does not consider that it is necessary to place additional requirements to publish information on the FCA.

**4.13** A number of additional detailed comments were raised by respondents in relation to the transposition of Article 57 MiFID II. The government has adopted a number of these suggestions and considers that overall the regulations reflect an intelligent copy-out of Article 57 MiFID II.

**Question 7. Do you agree that the amendments to the Recognition Requirements Regulations adequately transpose the position reporting and management regime established by Article 57 and 58 of MiFID II?**

**4.14** Respondents broadly agreed that the amendments to the Recognition Requirements Regulations adequately transposed the position reporting and management regime as established by Article 57 and 58 MiFID II.

**4.15** Two respondents noted that the new paragraph 7BA(1)(c) and (d) in the schedule to the Recognition Requirements Regulations which were published with the consultation omitted the words "appropriate" and "where appropriate", respectively, which are used in the corresponding provision in Article 57(8) MiFID II. One respondent noted that the words "appropriate" and "where appropriate" in the new paragraph 7BA(1)(c) and (d) were necessary to ensure that a trading venue which trades commodity derivatives could not exercise these controls unless appropriate for the purposes of the position limit regime.



**4.16** More generally, one respondent suggested that FCA guidance should be provided in relation to the actions that an exchange can undertake when applying the position management controls outlined in paragraph 7BA.

**4.17** Another respondent asked whether trading entities of industrial groups that are licenced under MiFID would be classified for the purpose of paragraph 7BB as an investment firm or a commercial undertaking.

**4.18** A further respondent asked that it be clarified that the Recognition Requirements Regulations only applies to RIEs and not to multilateral trading facilities (MTFs) and organised trading facilities (OTFs).

**4.19** The government notes the responses received in relation to the precise wording of paragraph 7BA in the schedule to the Recognition Requirements Regulations. The government agrees that it is important that trading venues only exercise the actions in paragraph 7BA (1)(c) and (d) where it is appropriate to do so. The regulations have therefore been revised to follow a closer copy-out of Article 57(8) MiFID II.

**4.20** The government notes that the FCA consulted on guidance for RIEs in relation to position management and position reporting in CP 15/43<sup>3</sup>. The FCA will publish their policy statement on this consultation in 2017.

**4.21** The government can confirm that a trading entity authorised under MiFID II is to be classified as an investment firm for the purposes of aggregated position reporting by different categories of person under paragraph 7BB.

**4.22** As set out in the consultation document, the position reporting and management regime is transposed by amendments to the Recognition Requirements Regulations to the extent that trading venues, which includes regulated markets, MTFs and OTFs, are operated by RIEs. Where these obligations apply to investment firms and credit institutions operating trading venues, they will be detailed in FCA rules.

**Question 8. Do you agree that the position reporting and management regime established by Articles 57 and 58 of MiFID II for investment firms and credit institutions operating trading venues be detailed in FCA rules?**

**4.23** All of the responses received agreed that the position reporting and management regime establishing by Articles 57 and 58 MiFID II for investment firms and credit institutions operating trading venues should be detailed in FCA rules.

**4.24** One respondent questioned whether the FCA would have sufficient rule-making powers in relation to the Article 58(2) and (3) MiFID II obligations. In particular, the respondent suggested that the Article 58(2) MiFID II requirements applied to Article 2 exempt firms and firms who are not authorised as investment firms under MiFID II but whose regular occupation or business is the provision of investment services and/or activities. The respondent questioned whether the FCA had rule-making powers in relation to these persons.

**4.25** The respondent also questioned whether the FCA would have sufficient powers to require members or participants of regulated markets and MTFs, and clients of OTFs, to report to the investment firm or market operator operating the relevant trading venue the details of their positions held through contracts traded on that venue in accordance with Article 58(3) MiFID II.

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<sup>3</sup> <https://www.fca.org.uk/publications/consultation-papers/cp15-43-markets-financial-instruments-directive-ii-implementation>

**4.26** The government considers that the FCA has sufficient powers in relation to the Article 58(2) and (3) MiFID II position reporting obligations. The government considers that Article 58(2) is clear that it only applies to investment firms and that the FCA has rule-making powers in relation to these firms. In regards to the obligations under Article 58(3), regulation 17 in the Main Regulations provides the FCA with the power to direct persons to provide information. The FCA consulted on using this power to meet the Article 58(3) obligations in CP 16/19<sup>4</sup>.

**4.27** More generally, CP 16/19 sets out the rules concerning the position reporting and management regime in relation to investment firms and credit intuitions. The FCA will publish their policy statement on this consultation in 2017.

**Question 9. Do you agree that the powers of the FCA reflect those provided for under MiFID II? In particular, in relation to Article 69(2)(j) and 69(2)(p) MiFID II?**

**4.28** One respondent raised a concern that the powers of intervention provided for in regulation 12 of the consultation stage Main Regulations did not explicitly place a restriction on when the FCA may use them. The same respondent also questioned whether the powers of intervention should apply to persons irrespective of whether or not they are in the United Kingdom.

**4.29** The FCA can only use these intervention powers for the purposes of MiFID II and MiFIR. This has now been clarified in regulation 19(2). The powers of intervention apply to all persons within scope of positions limits established by the FCA, whether or not they are in the UK, as specified in regulation 19(3).

**Question 10. Do you have any further comments on the drafting of the secondary legislation in respect of the position limits and reporting regimes?**

**4.30** One respondent asked for a clarification that the FCA taking action against a person for breaches under the Regulations does not preclude a trading venue from also taking action under their rules.

**4.31** The government can confirm that the FCA taking action against a person for breaches under the Regulations does not preclude a trading venue from applying its management controls as required by the new paragraph 7BA in the schedule to the Recognition Requirement Regulations, as well as complying with other relevant legal obligations.

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<sup>4</sup> <https://www.fca.org.uk/publication/consultation/cp16-19.pdf>

# 5 Unauthorised persons

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**5.1** MiFID II will apply to certain persons in circumstances where they are otherwise exempt from being authorised. These include, for example, those dealing on their own account in commodity derivatives, or providing non-algorithmic investment services in commodity derivatives as an ancillary activity to their main (non-investment) business. In order for the FCA to be able to fulfil its obligations under the directive, the government proposed that it was necessary to provide the FCA with various powers in relation to such unauthorised persons. These were set out in Part 4 and Part 5 of the consultation stage Main Regulations<sup>1</sup> and provided the FCA with the power to be able to impose and enforce remedies on unauthorised persons if they breach their regulatory obligations.

**Question 11. Do you agree with the transposition drafting and approach to unauthorised persons?**

**5.2** Respondents broadly agreed with the government's transposition drafting which applies Articles 17(1) to (6) MiFID II to members or participants of regulated markets and MTFs who are not required to be authorised under MiFID II under points (a), (e), (i) and (j) of Article 2(1).

**5.3** One respondent stated that their understanding was that the conditions specified in regulation 11(1)(a)-(c) and regulation 12(1)(a)-(c) of the consultation stage Main Regulations, were intended to be cumulative and sought clarity over whether that was correct.

**5.4** Another respondent considered that the conditions for when regulations 11-13 in the consultation stage Main Regulations were applicable could create uncertainty about whether the Regulations apply. The relevant condition stated that the Regulations apply to a person who is not authorised to perform investment services and activities under Part 4A of FSMA. The respondent considered this to give rise to uncertainty as Part 4A permissions relate to the ability to perform regulated activities, rather than "investment services and activities". The respondent provided an alternative drafting suggestion.

**5.5** The government will maintain its approach to transposing the Article 17(1)-(6) MiFID II requirements with respect to members or participants of regulated markets and MTFs who are not required to be authorised under MiFID II pursuant to Article 2(1) MiFID II, (a), (e), (i) and (j).

**5.6** The government can confirm that the conditions specified in regulations 11(1) and 12(1), which are now regulations 21(1) and 23(2) respectively, are cumulative.

**5.7** The drafting of the Regulations have generally been reviewed and revised since the consultation. This should address the general drafting points raised in the responses.

**Question 12. Do you agree that the powers provided to the FCA in respect of unauthorised persons are appropriate in light in particular of Article 69 MiFID?**

**5.8** All respondents agreed that the powers provided to the FCA in respect of unauthorised persons are appropriate and in line with Article 69 MiFID II. Accordingly, the government will maintain its proposed approach to providing the FCA with powers in respect of unauthorised persons.

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<sup>1</sup> Now Parts 4 and 6 of the Main Regulations.

## Benchmarks regulation

**5.9** Article 37 MiFIR applies to any person with a proprietary right to a benchmark. At the time of consultation, the government noted that it was unclear whether following the finalisation and application of the Commission's proposal for a regulation on benchmarks it would be necessary to consider an amendment to Part XI FSMA to provide the FCA with relevant powers concerning enforcement and rights of information in relation to such persons.

**5.10** The Benchmarks Regulation has now been published in the Official Journal of the EU<sup>2</sup>. The government will consider alongside the implementation of the Benchmarks Regulation whether such an amendment to FSMA is necessary in respect of unauthorised persons with proprietary rights to a benchmark in order to appropriately enforce the obligations in Article 37 MiFIR.

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<sup>2</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016R1011&from=EN>

## 6 Structured deposits

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**6.1** MiFID II applies some of its investor protection requirements to firms when they sell, or advise clients in relation to, structured deposits. The government proposed that in order for the PRA and FCA to be able to effectively supervise the obligations in these provisions it was necessary to bring certain regulated activities within the UK regulatory perimeter when carried on in relation to structured deposits.

**Question 13. Do you consider the regulated activities that have been “switched on” on for structured deposits are appropriate to cover the Article 1(4) MiFID II concepts of “selling or advising”? In particular, is it appropriate to treat Article 25(2) RAO and Article 37 RAO as within the meaning of “selling”?**

**6.2** Respondents broadly agreed that the list of regulated activities switched on in relation to structured deposits in the amendments to the Regulated Activities Order (RAO), including article 25(2) RAO, reflect the MiFID II article 1(4) concept of “selling” or “advising”.

**6.3** However, two respondents said that article 37 RAO (“Managing investments”) should not be switched on. The respondents considered that managing an investment as specified under article 37 RAO, in particular taking a discretionary decision to buy an investment on behalf of another, in itself does not constitute “selling” in accordance with the meaning of Article 1(4) MiFID II. The respondents accepted that in instances where a person is managing an investment, they would as part of that role typically buy or sell investments. However, the respondent opined that in such cases that activity would be captured by virtue of article 21 or article 25(1) of the RAO being switched on.

**6.4** One respondent questioned whether article 14 RAO (“Dealing in investments as principal”) should also be switched on to capture credit institutions issuing structured deposits. The respondent noted that the draft amendments to the Financial Promotions Order (FPO) extended the financial promotion definition to bring in both the activities of dealing in investments as principal and as agent in relation to structured deposits. They argued therefore that it would be necessary to switch on article 14 of the RAO in relation to structured deposits to ensure the RAO and the FPO are consistent.

**6.5** As set out in the consultation, the government’s view is that “managing” necessarily includes within it the purchase or sale of investments. The government considers that it is possible for a person who is managing an investment to “sell” to a client a structured deposit without otherwise being captured wholly by article 21, article 25(1), article 25(2) or article 53 RAO. The activity of taking a decision to deal is also an important part of whether a product is sold to a client when they are using a discretionary investment management service and subject to specific investor protection rules regarding suitability. The government therefore considers that it is necessary to switch on article 37 RAO in relation to structured deposits.

**6.6** The government agrees that “issuing” or accepting structured deposits is captured by the concept of “selling”. However, the government’s view is that the activity of a credit institution accepting structured deposits is already captured by article 5 RAO and does not require article 14 RAO to be switched on in relation to structured deposits. Similarly, the government considers that the amendments to the RAO are consistent with the amendments to the FPO in relation to structured deposits and take due consideration of the existing drafting and approaches in both orders.

**6.7** The government will therefore maintain its proposal to switch on article 21, article 25(1), article 25(2), article 37 and article 53 RAO in relation to structured deposits.

**Question 14. Is the definition of structured deposits provided at Article 3 RAO clear?**

**6.8** The majority of respondents agreed that the definition of structured deposits provided for in article 3 RAO was sufficiently clear.

**6.9** One respondent noted that there are two definitions of “deposit” in the RAO, in article 5 and article 60L. The respondent suggested to improve clarity that a direct reference should be made to the article 5 definition of deposit in the amendment to article 3 (which introduces the definition of “structured deposit” into the RAO).

**6.10** The same respondent was also concerned that the exclusions to article 5 contained within articles 6 to 9A might also apply to activities in relation to structured deposits, as per the new definition in article 3.

**6.11** The government does not consider that it is necessary to further amend article 3 to reference the article 5 definition of deposit. This is because article 3 of the RAO already makes clear that “deposit” is as defined in article 5 except where the definition contained in article 60L applies.

**6.12** The government notes that the sums of money falling within articles 6 to 9A RAO are excluded from the activity of accepting deposits. As stated in the consultation, the government considers that structured deposits are necessarily a subset of deposits. As such, it is correct that sums of money falling within articles 6 to 9A RAO, which are excluded from the activity of accepting deposits, are also excluded from the definition of structured deposits.

**Question 15. Do the amendments to the FPO ensure consistency between it and the amended RAO activities in relation to structured deposits?**

**6.13** A number of respondents did not consider the amendments to the FPO to be consistent with the amendments to the RAO in relation to structured deposits. One respondent in particular noted that the amendments to the FPO did not turn on the financial promotion restrictions for article 53 RAO when done in relation to structured deposits.

**6.14** The government welcomes this response. The amendments to the FPO have been revised to reflect the RAO activity that has been turned on in relation to structured deposits. This now includes article 53 RAO.

**Question 16. Do you have any further comments on the draft secondary legislation in relation to structured deposits?**

**6.15** One respondent suggested the amendment to article 22 FPO could be made in a different way in order to make the provision easier to understand.

**6.16** The government considers that article 22 as amended is sufficiently clear and will maintain the current drafting.

# 7 Power to remove board members

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**7.1** MiFID II requires that national competent authorities have the power to remove a person from the management board of an investment firm or market operator. The government consulted on two options to transpose this power. Option A was to rely on existing FSMA powers. Option B was to create a new standalone power.

**7.2** As part of the Approved Persons Regime (APR) and of the new Senior Managers and Certification Regime (SM&CR), the FCA (and for some firms, the PRA) (collectively “the regulators”) have the power under FSMA to withdraw the approval of a person performing a “Controlled Function” (i.e. an Approved Person, including an individual performing a Senior Management Function (SMF)). The regulators also have various other powers, including the power to prohibit individuals, irrespective of whether they are Approved Persons or not, from performing either a particular function or any function in a regulated financial services firm, if they are found no longer “fit and proper” to perform such a function. As such, existing powers could be regarded as adequately transposing the requirements of the directive where board members are Approved Persons. However, the existing powers do not extend to RIEs and the procedure for withdrawing approved status or varying an approval to perform an SMF is arguably not suitable in urgent situations.

**7.3** The consultation outlined that a standalone power could be an alternative. In particular, the FCA or PRA could be given the ability to require a firm to remove immediately any member of a board (whether an Approved Person or not) where a set of specific conditions are met or where specific circumstances arise. Under either option, amendments were considered necessary to extend the FCA’s powers of removal to include RIEs.

**Question 17. Do you consider that existing FSMA powers are sufficient for the purposes of Article 69(2)(u) MiFID? If yes, please explain how these powers do not suffer from the limitations mentioned above.**

**7.4** Seven respondents considered existing FSMA powers to be sufficient for the purposes of transposing Article 69(2)(u) MiFID II in relation to investment firms. These respondents generally preferred to rely on existing powers, where the procedures that must be followed by the FCA or PRA to exercise them are known, rather than introducing a new power.

**7.5** One respondent accepted that there was a need to extend the scope of existing FSMA powers to certain persons not covered by the existing regime. In relation to firms which are subject to the SM&CR, they noted that not all non-executive directors require approval as senior managers under the SM&CR.

**7.6** A number of respondents also noted that MiFID II does not specify a time period in which competent authorities should be able to require the removal of a natural person from the management board.

**7.7** The government, having carefully considered the options, does not consider that existing FSMA powers are sufficient for the purposes of transposing Article 69(2)(u) in relation to investment firms.

**7.8** In particular, this is because not all natural persons on a management board of a designated investment firm will necessarily be an Approved Person. An example may be a

non-executive director of a PRA designated investment firm who does not chair the board, a key board committee or perform the role of Senior Independent Director. These individuals do not perform an SMF and are therefore not Approved Persons. As a result, the FCA or PRA would not be able to use their powers to withdraw the approval of such persons, although (as noted above) they can prohibit them from performing any function in a regulated financial services firm.

**7.9** More generally, while an approval under the Approved Person Regime can be suspended or limited for misconduct, it can only be withdrawn if an individual is not “a fit and proper” person to carry out a Controlled Function. This is similar to the test that applies to prohibition orders under Section 56 FSMA. An SMF’s approval can be varied for broader reasons, for example, to advance the FCA’s operational objectives. However, these reasons do not align with the requirements of Article 69(2)(u) which relates to the removal of a member of the management board in order to enable a competent authority to fulfil their duties under MiFID II.

**7.10** The government has therefore set out in Part 5 of the Main Regulations a standalone power in relation to investment firms, which follows an intelligent copy out of Article 69(2)(u).

**7.11** The government notes that by virtue of Article 1(3) MiFID II, Article 69(2)(u) also applies to credit institutions. Accordingly, Part 5 has been applied to credit institutions.

**Question 18. Do you agree that FSMA powers in relation to market operators have to be amended either under Option A or B?**

**7.12** All respondents, except one, agreed that FSMA powers in relation to market operators would need to be amended under either Option A or B. One respondent noted that this would be necessary in order to ensure a level playing field between investment firms and market operators.

**7.13** One respondent acknowledged that relying on existing FSMA powers could create a gap in the scope of the persons to which Article 69(2)(u) applied, and therefore that amendments may be necessary in relation to market operators. The respondent preferred the government not to extend the powers in relation to RIEs through the APR.

**7.14** By contrast, another respondent proposed bringing RIEs within the scope of the APR to provide regulators with the necessary powers to remove board members from an RIE.

**7.15** One respondent, who also acknowledged that the existing APR and SMCR did not apply to RIEs, considered that Section 56 FSMA which provides the FCA with the power to make a prohibition order in relation to individuals performing regulated activities could be applied to RIEs. They therefore considered that no further amendment was necessary.

**7.16** The government is of the view that FSMA powers in relation to market operators need to be amended to effectively transpose Article 69(2)(u). As set out above, the government does not consider that Section 56 FSMA is sufficient to transpose Article 69(2)(u) in relation to market operators as the test that applies does not align with the requirements of MiFID II.

**7.17** The government proposed in the consultation amending Section 296 of FSMA to provide the power to require an RIE to remove an individual who sits on the relevant entity’s board or place restrictions on such an individual. However, in light of the new standalone power created for investment firms and credit institutions in Part 5, the government considers that it is preferable for consistency that the same regulations should also apply to market operators. Part 5 has therefore been applied to RIEs.



**Question 19. Do you consider that Option B is appropriate to transpose Article 69(2)(u) MiFID? If not, please specify what your preferred alternative option is and how this meets Article 69(2)(u) of MiFID?**

**7.18** The majority of respondents referred to their answers to question 17 and noted that they did not consider amendments to FSMA in relation to investment firms (as outlined in Option B) to be necessary.

**7.19** A number of respondents agreed that Option B was appropriate in relation to market operators to transpose Article 69(2)(u).

**Question 20. What factors do you think should be taken into account in relation to the drafting of the standalone power suggested at Option B? Please provide answers both in relation to the proposal for investment firms and market operators.**

**7.20** A number of respondents proposed that if standalone powers were to be created as suggested at Option B that clarity would need to be given over the conditions under which the regulator could exercise the powers. For example, how serious the action would need to be in order to merit removal of a natural person from the management board.

**7.21** One respondent proposed that the powers should be limited so that the regulator could only require the removal of a board member for MiFID II purposes.

**7.22** As set out in the responses to question 17 and 18, the government will introduce a standalone power which reflects an intelligent copy out of Article 69(2)(u) in relation to investment firms, credit institutions and market operators.

**7.23** As such, Part 5 provides for the appropriate regulator to remove a member of the management board of an investment firm, credit institution or a recognised investment exchange if considered necessary to fulfil their duties under MiFID II and MiFIR. As outlined in the consultation, the government considers that in order for the appropriate regulator to be able to fulfil their duties under MiFID II and MiFIR, they should be able to remove such members with immediate effect.

**7.24** Where the appropriate regulator proposes to impose such a requirement on an investment firm, credit institution or RIE, they must give written notice as specified in regulation 31. Under these Regulations, the person to whom the requirement relates, and the investment firm, credit institution or RIE will have the right to refer to matter to a tribunal.

**7.25** The appropriate regulator for the purposes of PRA authorised persons shall be the PRA and the FCA. The government considers that this is necessary in order to enable the PRA and the FCA to fulfil their duties under MiFID II and MiFIR. Regulation 29(3) further specifies that the FCA should consult the PRA (as lead regulator) before exercising these powers under regulation 29(2)(a) in respect of a PRA authorised person. The government also notes that this is consistent with the existing framework under FSMA.

**7.26** The government will provide the PRA with relevant administration and enforcement powers in relation to Part 5 in due course. These powers will be akin to those provided to the FCA in respect of Part 5.



# Organised trading facilities

## 8

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**8.1** MiFID II creates a new category of trading venue: organised trading facilities (OTFs). OTFs, like regulated markets and multilateral trading facilities, are a type of multilateral system in which multiple buying and selling interests can interact in a way that results in contracts. However, OTFs can only facilitate the trading of non-equity financial instruments on a discretionary basis.

**8.2** Investment firms and market operators operating OTFs are permitted to conduct matched principal trading in bonds, structured financed products, emission allowances and certain derivatives where a client has consented to the process, and to deal on own account other than matched principal trading in sovereign bonds where they do not have a liquid market. The government proposed that OTFs would not be required to obtain a separate permission dealing on own account. It was suggested that the restrictions on these forms of trading by OTFs and notification to the FCA that an OTF was undertaking such trading would be more appropriately dealt with in FCA rules. The government also proposed that applications to operate an OTF will be able to be submitted before MiFID II comes into forces on 3 January 2018, in order to ensure an efficient authorisation process.

**Question 21. Do you agree that the amendments to the RAO and the Recognition Requirements Regulations appropriately transpose the MiFID II investment service of operating an OTF? In particular, do you agree that it is unnecessary to require firms to apply for a separate dealing in investments as principal permission, in addition to the activity of operating an OTF, if they engage in matched principal trading as an operator?**

**8.3** Respondents agreed that the amendments to the RAO and the Recognition Requirements Regulations appropriately transposed the MiFID II investment service of operating an OTF.

**8.4** The majority of responses to this question related to whether it was necessary to require firms to acquire a separate permission in order to “deal in investments as principal”, in addition to being authorised to undertake the activities of an OTF, when undertaking matched principal trading as an operator.

**8.5** Respondents agreed with the government’s view that it is unnecessary to require a separate permission and that a notification regime would be both sufficient and proportionate.

**8.6** The government will maintain its amendments to the RAO and the Recognition Requirements Regulation. Accordingly, a notification regime will be provided for in FCA rules in relation to RIEs, investment firms and credit institutions operating an OTF and undertaking matched principal trading.

**8.7** The FCA consulted on this notification regime in CP 15/43<sup>1</sup>. The FCA’s proposals outline that operators of an OTF undertaking matched principal trading should provide the FCA with a detailed description of its use of matched principal trading. The FCA will also create a standard limitation for use by firms operating an OTF and matched principal trading as part of that same activity.

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<sup>1</sup> <https://www.fca.org.uk/publications/consultation-papers/cp15-43-markets-financial-instruments-directive-ii-implementation>

**Question 22. Do you have any additional comments on how the Government has transposed the MiFID II OTF regime?**

**8.8** One respondent sought clarity over whether the government's proposed amendments to the FPO would apply only to financial instruments (as defined in MiFID II) which are traded on an OTF.

**8.9** Another respondent asked for a clarification that an RIE operating an OTF could perform this regulated activity using its existing recognition under Part 18 FSMA, instead of applying for a specific Part 4A FSMA authorisation.

**8.10** A further respondent raised concerns in relation to non-discriminatory access to the facilities of an OTF. In particular, the respondent suggested that UK legislation should provide further detail on the principle of "non-discriminatory access" to more effectively prohibit trading venue rules or practices that would violate this principle.

**8.11** The government can confirm that the proposed changes to the FPO in respect of the new controlled activity of operating an OTF will apply only to MiFID II non-equity financial instruments.

**8.12** The government can also confirm that an RIE will not need a Part 4A permission to operate an OTF. An RIE will be able to operate an OTF as a recognised body under Part 18 FSMA subject to approval by the FCA based on the requirements set out in the Recognition Requirements.

**8.13** Finally, the government agrees that non-discriminatory access to the facilities of an OTF is an important principle and which is required by MiFID II. This will be transposed through the Recognition Requirements Regulations for market operators operating an OTF and through FCA Rules for investment firms and credit institutions operating an OTF. This will enable the FCA to supervise firms against this requirement and take enforcement action where necessary. The government considers this approach to be consistent with that taken in relation to MTFs. The government understands that further detail on non-discriminatory access is likely to be provided in level 3 materials from ESMA.

# 9 Binary options

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**9.1** Binary options are a form of financial contract which typically pays a fixed sum if the option is exercised or expires in the money, or nothing at all if the option is exercised or expires out of the money. In a Question and Answer on the scope of the existing MiFID the Commission said that some binary options are financial instruments. The government proposed that given the growth of the binary options market and concerns about consumer protection it is appropriate to treat binary options relating to certain underlyings as MiFID financial instruments. This will bring them within the UK regulatory perimeter and ensure that investor protections which apply for similar derivative contracts also apply to these contracts.

**Question 23. Do you agree that binary options should be treated as financial instruments under the existing MiFID?**

**9.2** All respondents agreed that binary options should be treated as financial instruments under MiFID.

**9.3** A number of respondents noted that treating binary options as financial instruments would increase the consistency of the level of investor protection offered to consumers across similar products. One respondent also welcomed the additional benefits to consumers of classifying these binary options as MiFID financial instruments. These include, for example, access to the Financial Ombudsman Service and the Financial Services Compensation Scheme.

**9.4** The government welcomes the responses received and confirms it will legislate to treat binary options as financial instruments.

**Question 24. Do you agree with the scope of the coverage of the binary options proposed in the amendment to Article 85 of the RAO? If not, what do you think the scope should be?**

**9.5** The majority of respondents agreed with the scope of the coverage of the binary options proposed in the amendment to Article 85 of the RAO.

**9.6** Whilst one respondent agreed with the scope of the amendment, the respondent noted that such binary options could include complex features, for example, a “buy-back” feature which if used means the pay-off before expiry is not binary.

**9.7** One respondent stated that it was difficult to distinguish between “financial” and “non-financial” binary options and as a result suggested that the amendment should be extended to capture all binary options. This would mean binary options which have a non-financial underlying would also be regulated by the FCA.

**9.8** The government acknowledges the concerns raised. The government considers that where binary options present similar risks to other derivative products, they should be regulated in a similar way. This includes ensuring that consumers receive at least an equivalent level of protection as with other such derivative products.

**9.9** The government considers that it is important to limit the perimeter to binary options with certain underlyings, for example, those that relate to financial instruments, and not bring into scope contracts that are in fact more comparable to bets. The consequence of the drafting is that a binary option is a financial instrument in circumstances where similar derivative contracts would also be regarded as financial instruments, including where the option relates to currencies, stock indices, individual shares, commodity prices and economic statistics.

**9.10** In relation to the specific amendments to Article 85, which bring certain binary options within the scope of RAO, the government considers that it is sufficiently clear that a binary option should be regarded as a financial instrument where it is settled in cash and is a financial instrument for the purposes of paragraphs 4 to 7 and 10 of Section C of Annex 1 to MiFID II, or where Articles 5 to 8 and 10 of the Commission Delegated Regulation of 25 April 2016<sup>1</sup> applies. References to MiFID and its implementing regulation in the consultation stage draft have been updated to refer to the relevant MiFID II provisions, which replace them.

**9.11** The amendment to Article 85 as consulted on specified that a binary option should be “a derivative contract of a binary nature”. The government understands that contracts sold as binary options can have more than two payouts and therefore may not be clearly caught within the proposed amendments to Article 85 but could fall within the definition of a MiFID financial instrument. In light of this, the amendments to Article 85 RAO in relation to binary options has been changed to specify that a binary option should be a “derivative contract of a binary or other fixed outcomes nature”. Contracts for difference that are not binary options and have a variable payout are already a specified investment under Article 85(1).

**9.12** Further to the proposals set out in the consultation, and in light of increasing consumer protection concerns, the government considers that it is necessary that the act of making arrangements with a view to transactions in relation to binary options (Article 25(2) RAO) should be within the regulatory perimeter. This is consistent with the current treatment of contracts for difference.

**9.13** Accordingly, the new Article 85(4B)(e) RAO specifies that a binary option is a specified investment where a person is carrying on the activities specified by Article 25(2) RAO in relation to them.

**9.14** This will mean that introducing a person to a firm buying or selling binary options (as defined by the new Article 85(4A) RAO) is a regulated activity and will require authorisation when done by way of business, unless an RAO exclusion otherwise applies. As such, authorised persons undertaking this activity will be subject to the FCA’s Conduct of Business rules, including the requirement to treat clients honestly, fairly and professionally. The FCA’s recent consultation paper, CP16/40<sup>2</sup>, outlined the FCA’s early policy considerations and potential policy proposals for the regulation of binary options once they come within their regulatory perimeter.

**9.15** Schedule 1, paragraph 23 of the FPO has been also amended to include binary options (as defined by the new Article 85(4A) RAO) as a new controlled investment. Accordingly, binary options within the meaning of the new Article 85(4A) RAO will be considered a controlled investment in relation to financial promotions. This ensures the necessary consistency between the RAO and FPO. It is also considered beneficial to ensure that investor protections are strengthened through applying the financial promotion prohibition for unauthorised persons to binary options as it applies to other investments.

**9.16** The amendments to the RAO and the FPO in relation to binary options will come into force in line with the application date of MiFID II, which is 3 January 2018. Providers of binary options will be able to apply for authorisation by the FCA during the course of 2017.

**9.17** Ahead of the legislation coming into force, the government will consider whether consequential amendments to the Gambling Act 2005 are necessary in order to support the transfer of the regulation of relevant binary options from the Gambling Commission to the

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<sup>1</sup>[http://ec.europa.eu/finance/securities/docs/isd/mifid/160425-delegated-regulation\\_en.pdf](http://ec.europa.eu/finance/securities/docs/isd/mifid/160425-delegated-regulation_en.pdf)

<sup>2</sup><https://www.fca.org.uk/publication/consultation/cp16-40.pdf>

FCA. We will also consider appropriate fee arrangements to seek to minimise the burden on firms who hold a Gambling Commission Licence at the point the regulation is transferred. The government is also considering the implications of these legislative amendments for the relevant tax framework.





# 10 Further issues

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**10.1** Following the consultation, the government has identified a number of further issues in MiFID II which require legislative amendments as part of the transposition. This chapter sets out the changes a number of key changes which are reflected in the draft statutory instruments in the annexes.

## Commencement

**10.2** Parts of the statutory instruments will commence early in 2017 in order to enable firms to apply to the FCA or PRA for variations of permissions or authorisations where they are required to do so by MiFID II. The FCA<sup>1</sup> and PRA will have until 3 January 2018 to decide on completed applications received by 3 July 2017. This includes new permissions or authorisations as a data reporting service provider, for operating an organised trading facility, or regulated activities in relation to structured deposits or binary options. Similar provisions have been prepared for the purpose of passport notifications.

**10.3** Early commencement is intended to provide a smoother implementation of MiFID II by increasing the time available to firms to apply for variations of permissions or authorisations.

**10.4** The government will consider whether further provisions require early commencement. Early commencement will also be considered where it would be helpful to provide firms with greater certainty to in relation to specific provisions ahead of 3 January 2018.

**10.5** The remaining parts of the statutory instruments will be commenced on 3 January 2018. These contain all the provisions transposing substantive obligations in MiFID II and will only apply to relevant firms from the date of application of MiFID II.

## Foreign exchange derivatives

**10.6** The Commission has sought to harmonise the definition of financial instruments in relation to foreign exchange derivatives. Article 10 of the Commission Delegated Regulation of 25 April 2016 sets out that other derivative contracts relating to currencies are not financial instruments where, inter alia, they are a spot contract or a means of payment.

**10.7** Article 84 RAO has been amended to ensure the regulatory perimeter implements MiFID II with regards to other derivative contracts relating to currencies.

## Investor compensation scheme for market operators

**10.8** As part of seeking authorisation investment firms are required by Article 14 to meet their obligations under the Investor Compensation Directive (97/9/EC) by joining an authorised investor compensation scheme. In the UK, this means investment firms must be members of the Financial Services Compensation Scheme (FSCS).

**10.9** As the operation of an MTF or OTF is an investment service or activity, market operators operating an MTF or OTF have to meet similar regulatory requirements to investment firms when they operate an MTF or OTF.

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<sup>1</sup> As noted in the introduction, the FCA recently published their Application and Notification User Guide. The user guide also indicated that the FCA will accept draft applications for authorisation from early 2017. Further information can be found at: <https://www.fca.org.uk/publication/documents/mifid-ii-application-notification-guide.pdf>

**10.10** Under Article 5(2) of MiFID, market operators operating an MTF had to comply with the requirements in Chapter 1 of Title II which set out the conditions and procedures for authorisation as an investment firms. However, Article 5(2) specifically stated that Article 11, the requirement for an investment firm to meet its obligations under Directive 97/9/EC (i.e. to be a member of an investor compensation scheme), did not apply to market operators.

**10.11** The revised Article 5(2) of MiFID II also enables market operators to operate an MTF or OTF provided they comply with the requirements in Title II Chapter I setting out the conditions and procedures for authorisation as an investment firm. However, market operators operating an MTF or OTF no longer have a derogation from the requirement in Chapter 1 for an investment firm to meet its obligations under Directive 97/9/EC (which is now found in Article 14). This change was made to ensure consistency of obligations between market operators and investment firms when operating an MTF or OTF.

**10.12** This requirement will be transposed through amendments to Part 15 FSMA in Schedule 1 to the Main Regulations and to the rules governing the scheme. The FCA will consult in 2017 on how the FSCS applies to market operators operating an MTF or OTF.

### **Tied agents**

**10.13** Technical changes have been made in Schedule 1 to the Main Regulations to FSMA (Sections 39, 39A and 347) and the Appointed Representatives Regulations. These changes arise in particular because of the mandatory nature of the tied agents provisions in MiFID II, as opposed to the optional regulatory regime in MiFID. Further changes arise from new MiFID II requirements relating to structured deposits contained in the amendments to the RAO and Article 3 MiFID exempt firms (broadly advisers and arrangers who do not hold client money or assets, as part of their MiFID business).

### **Professional firms**

**10.14** We have updated the Part 20 FSMA regime for exempt professional firms to take account of the Article 2(1)(c) MiFID II exemption for professional firms, which has now been supplemented in a Commission delegated regulation (see new Section 327(4A)). The FCA recently issued draft guidance on the effect of the exemption in its CP 16/43<sup>2</sup>.

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<sup>2</sup> <https://www.fca.org.uk/publications/consultation-papers/cp16-43-mifid-ii-implementation-iv>

Australia and New Zealand Banking Group Limited  
BATS Chi-X Europe  
BlackRock  
BRP Bizzozero & Partners UK Ltd  
CME Europe Limited  
Complyport Limited  
Deutsche Boerse Group  
EDF Trading  
Euroclear UK and Ireland Limited  
Euronext  
Guernsey Financial Services Commission  
HSBC  
ICAP plc  
Isle of Man Financial Services Commission  
Jersey Financial Services Commission  
London Stock Exchange Group  
MarketAxess  
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The Association of Foreign Banks  
The British Bankers Association  
The British Private Equity and Venture Capital Association  
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