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## FCA Second Policy Statement on MIFID II



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## Introduction

The FCA has published its second policy statement on the implementation of MiFID II (PS17/14). PS17/14 summarises the feedback the FCA received to issues raised in its consultation papers on MiFID II, namely CP15/43, CP16/19, CP16/29, CP16/43 and CP17/8, but concentrates in particular on the client asset rules from CP16/19 and the conduct of business rules from CP16/29. PS17/14 follows the FCA's first policy statement on the implementation of MiFID II (PS17/5), which was published in March this year. The first policy statement covered the FCA's near-final rules on markets issues and organisational requirements, including systems and controls, client assets and commodity position limits.

The rules set out in PS17/14 are final. The FCA has also finalised the near-final rules published in its first policy statement.

The remainder of this note relates solely to the conduct of business rules which the FCA consulted on in CP16/29, as these generated the majority of feedback received by the FCA and are of particular interest to investment managers.

## Conduct of business rules

Chapters 6 to 19 of PS17/14 cover the conduct of business rules, as follows:

- chapter 6 – Inducements, including adviser charging
- chapter 7 – Inducements relating to research
- chapter 8 – Client categorization
- chapter 9 – Disclosure requirements
- chapter 10 – Independence
- chapter 11 – Suitability
- chapter 12 – Appropriateness
- chapter 13 – Dealing and managing
- chapter 14 – Underwriting and placing
- chapter 15 – Investment research
- chapter 16 – Client agreements
- chapter 17 – Product governance

- chapter 18 – Knowledge and competence
- chapter 19 – Taping

In response to feedback received on CP16/29, the FCA has made significant policy changes to some of its proposals, but for others it has maintained its approach. The following chapters are of particular interest:

### *Chapter 6 – Inducements, including adviser charging*

The FCA has confirmed that it is taking forward the changes necessary to implement the MiFID II inducement ban in relation to independent advice and is extending these requirements to the provision of restricted advice, but only where restricted advice is provided to retail clients in the UK.

The FCA is also proceeding with its consultation proposals concerning the additional requirements of banning firms that provide independent or restricted advice or portfolio management services to retail clients from accepting and rebating monetary benefits to such clients. The FCA considers that this is a necessary alignment with its existing Retail Distribution Review (RDR) approach.

As suggested in the consultation responses, the FCA will limit the territorial application of the additional domestic requirements so that they only apply where the retail client is in the UK. This means that firms providing independent advice or portfolio management services to retail clients outside the UK will be subject to the same MiFID II requirements as those providing independent advice or portfolio management services to professional clients.

While the FCA will not extend the ban on receiving and rebating monetary benefits in relation to services to professional clients, the FCA notes that firms may, from a practical point of view, take a commercial decision not to accept and rebate third party payments in relation to



professional clients in order to apply consistent standards across their business.

The FCA also notes that it is finalizing its rules on the basis that Article 3 firms will be subject to the same requirements in relation to inducements as MiFID firms.

#### *Chapter 7 – Inducements relating to research*

Under MiFID II, investment research is treated as an inducement and may only be received by a firm if it is paid for either: (a) directly by the investment manager out of its own resources; or (b) from a separate research payment account (RPA) controlled by the investment manager and funded through a specific research charge to the client based on a research budget which has been pre-agreed with the client

The FCA has generally replicated the MiFID II requirements; however, in line with the current scope of the dealing commission regime, it has gold-plated the requirements such that they will apply not only to investment firms that are subject to MiFID II, but also to collective portfolio managers, including AIFMS (both full-scope and small), UCITS management companies and residual CIS operators. However, an exemption has been provided for private equity business i.e. AIFs and CISs whose core investment policy does not generally involve investing in financial instruments that are not capable of being held in custody or in issuers or non-listed companies in order to acquire control of those companies.

In response to consultation feedback, the FCA is amending its guidance on how quickly research charge deductions should be passed into the RPA to allow greater flexibility – the transfer of research charges should be effected without undue delay and in any event within 30 calendar days. The FCA has also clarified that it does not intend to require investment managers to have a single RPA per research budget, provided it is still adequately protected in accordance with the rules, and further that investment firms do not have to price separately to third country firms based outside the EEA, although they may choose to do so voluntarily.

The FCA has clarified that a firm can accept transaction reporting as part of the execution services, provided it does not influence best execution, but execution will not extend to unrelated services e.g. provision of third party trade analytic tools, order management systems or RPA administration services. These will need to be paid for out of the manager's own resources.

Finally, the FCA has not provided a list of what may constitute research, but refers to ESMA's guidance in its Q&As on MiFID II and MiFIR as to what can be considered a minor non-monetary benefit.

#### *Chapter 8 – Client categorisation*

It is a MiFID II requirement that local authorities are categorised as retail clients and may only be treated as a professional client if they elect to be treated as such. The FCA has revised its previously proposed threshold for local authorities opting up to elective professional client status.

The revised criteria specify a lower threshold for the size of portfolio that a local authority has to have and makes it easier for local authorities investing on behalf of a local government pension scheme pension fund to opt-up to professional client status if they wish to.

#### *Chapter 12 – Appropriateness*

The FCA has maintained its view that collective investment undertakings other than UCITS (including non-UCITS retail schemes (NURS) and investment trusts) are neither automatically non-complex nor automatically complex, but must be assessed against the criteria set out in MiFID II and further that, when firms apply these criteria, they should adopt a cautious approach if there is any doubt as to whether a financial instrument is non-complex.

#### *Chapter 13 – Dealing and managing*

The FCA has extended the MiFID II best execution requirements to UCITS management companies, with some modifications, and to Article 3 firms.



The FCA will not however, contrary to the proposals it consulted on, apply the changes in the best execution rules in MiFID II to full-scope AIFMs, including those AIFMs with 'top-up' MiFID permissions, although it intends to keep this under consideration and to take into account the outcome of the European Commission's review of the AIFMD.

The FCA will delay extending the MiFID II best execution requirements to small authorised AIFMs and residual CIS operators.

### *Chapter 17 – Product governance*

This chapter confirms the FCA rules in relation to product governance requirements for manufacturers and distributors and applies to firms within the categories listed at chapter 1.3.1R of the new PROD sourcebook. This list includes a MiFID investment firm, as well as an Article 3 firm. PROD will apply to firms providing discretionary portfolio management, as this investment service is within the definition of distributing.

The FCA has confirmed that the MiFID II product governance rules will apply as guidance to firms undertaking non-MiFID business.

### *Chapter 19 – Taping*

MiFID II requires in-scope firms to record telephone conversations and electronic communications that occur when providing client order services that relate to the reception, transmission or execution of client orders, or when dealing on own account.

In response to the feedback received, the FCA will not apply a requirement for recording phone conversations and electronic communication ('taping') to all investment services and activities carried out in relation to corporate finance business. However, communications occurring during corporate finance business will be within scope of the taping requirements insofar as they are automatically captured by the MiFID II requirements.

The FCA has confirmed the removal of the partial exemption for discretionary investment managers, such that all UK investment managers will be subject to the MiFID II requirements. In relation to these requirements extending to an AIFM, the FCA has clarified that the focus of the regime is on the transactional side of portfolio management and accordingly conversations and records regarding operational activities would not be captured by the requirements.

The FCA has also decided that where Article 3 firms decide to take a note rather than record a telephone conversation, it expects the note to include key details of any orders taken and the key substance of the main points of the conversation.

The FCA has also confirmed that it will continue with its approach to apply the MiFID II taping requirements to energy market participants, oil market participants and firms conducting other non-MiFID commodity and exotic derivatives business.

### *Next Steps*

The FCA advises those firms who still need to apply for authorization or variation of permission to do so as a matter of urgency, although it does not guarantee that these applications will be determined by 3 January 2018, the MiFID II application date.

PS17/14 can be found at the following link: [www.fca.org.uk/publication/policy/ps17-14.pdf](http://www.fca.org.uk/publication/policy/ps17-14.pdf).



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## Contacts



Claire Cummings

T: +44 (0) 207 585 1406

[claire.cummings@cummingslaw.com](mailto:claire.cummings@cummingslaw.com)



Helen Busby

T: +44 (0) 207 585 1406

[helen.busby@cummingslaw.com](mailto:helen.busby@cummingslaw.com)



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[www.cummingslaw.com](http://www.cummingslaw.com) | +44 (0)20 7585 1406