Introduction

On 03 July 2017, the FCA published its long awaited Policy Statement PS 17/14 “Markets in Financial Instruments Directive II Implementation – Policy Statement II” (the PS). Alongside the PS, the FCA also published a further consultation paper, CP 17/19, “Markets in Financial Instruments Directive II Implementation – Consultation Paper VI”, which deals with a small number of residual matters.

The PS represents a major step in the process of transposing MiFID2 into the UK’s regulatory regime ahead of 03 January 2018, when MiFID2 and MiFIR start to apply.

What does the PS contain?

In the PS, the FCA:

- sets out final rules on a number of conduct of business obligations for firms. (The FCA’s previous Policy statement, PS17/5, published on 31 March 2017, covered mainly markets and organisational requirements) and

- provides feedback on issues arising out of all five of its consultation papers on MiFID2 but dealing, in particular, with those covered in (i) CP 16/29, “Markets in Financial Instruments Directive II Implementation – Consultation Paper III” and (ii) CP 16/43, “Markets in Financial Instruments Directive II Implementation – Consultation Paper IV”.

The final rules include those on:

(a) Inducements - research
(b) Inducements – charging
(c) Client categorisation
(d) Disclosure requirements and other conduct issues (excluding client categorisation)
(e) Independence, Suitability and Appropriateness
(f) Dealing and Managing
(g) Underwriting and placing and Investment Research
(h) Product Governance
(i) Knowledge and Competency requirements
(j) Recording of telephone conversations
(k) SUP, authorisation changes
Scope of this note

In this note, we summarise the FCA’s key areas of implementation in the PS, focussing particularly on (i) differences between the FCA’s published final rules and the original EU legislation, and (ii) differences between the FCA’s final rules as published in the PS and the consultation versions of the rules published in 2016.

For the most part, this note assumes a baseline familiarity with both the original EU MiFID2 rules and with the FCA’s 2016 consultation work on MiFID2 implementation but, for more information on these matters, please refer to the Simmons & Simmons MiFID2 Tracker. Please note also that this note considers only implementation in the UK, and not other EU member states.

Overview

Much of MiFID2 is a “maximum harmonising” directive, which leaves the FCA little or no discretion as to how to implement MiFID2 in respect of those firms directly caught as a matter of EU law. In addition, a significant majority of the MiFID2 rules are contained within EU delegated regulations, which apply directly in EU member states - including the UK - without any need (or room) for national implementation. The FCA is, for the most part, adopting what it calls an “intelligent copy-out” approach for MiFID firms – i.e. adhering closely to the original wording of MiFID2, but adopting some alternative wording and minor additional guidance tailored to the UK market. As such, for those UK MiFID investment firms which are squarely caught by MiFID as a matter of EU law, there is little controversial or headline grabbing in the PS.

Consequently, much of the interest around the PS relates to firms other than MiFID firms (for example, AIFMs, UCITS Management Companies (ManCos), Article 3 exempt advisors) and how / to what extent the FCA proposes to gold-plate elements of the MiFID2 regime onto those categories of firms which would not otherwise be directly caught. The other key area of interest is the extent to which the UK retains as part of the UK regulatory regime parallel local standards – primarily in the retail sector - including the Retail Distribution Review (RDR), the Training and Competence rules, and the Senior Management and Certification Regime.

What does the FCA say in relation to these topics?

Looking at the key issues under each topic in the above order:

(a) Inducements - research

In the PS, the FCA states that its rules on inducements and research will apply not only to investment firms which are subject to MiFID2 but also to collective portfolio managers, including full-scope AIFMs, most small authorised UK AIFMs and UCITS ManCos.

Other than this gold-plating of scope, however, the FCA’s rules in this area ostensibly do not go beyond those required under MiFID2, although the FCA has provided significant additional commentary and guidance.

The FCA has also:

- confirmed that firms should ensure that the transfer of research charges into a research payment account (RPA) where using a third party to facilitate the deduction from clients, is effected without undue delay but within 30 calendar days from the transaction taking place. This is an improvement on the FCA’s previous proposal, which required the harsher timescale of “within the settlement cycle”. Firms should, however, consider earlier movements where possible/appropriate

- clarified that firms should have the ability to implement a combination of RPA-based methods and use of their own resources (i.e., profit & loss) to pay for external research. This flexibility may be helpful for firms when choosing the best model to fit the types of assets being managed (e.g., an equity portfolio versus fixed income) or depending on operational and regulatory constraints they may face in other jurisdictions in which they also operate. Firms are, however, required to consider whether a mixed funding approach would give rise to any potential conflicts of interest, either between the firms and its clients or between two groups of clients

- amended the list of acceptable minor non-monetary benefits to include trial periods for research services, subject to a number of conditions being met. These conditions include that
  - the trial period can only be for up to three months
  - the firm should not be required to provide any monetary or non-monetary benefit to the research provider during the trial and
  - the firm should not accept a new trial with the same provider within 12 months from the end of the previous trial. At the end of a trial period, a firm would need to either cease receiving it or establish a research agreement with the provider

- added to the list of ‘acceptable minor non-monetary benefits’ research that is written by a bank’s analysts on an issuer in the specific context of a primary market capital raising which the bank is underwriting (see Chapter 2.3A.19R of the FCA’s Conduct of Business Sourcebook (COBS))
allowed an exemption from its payment for research rules for AIFMs that follow Private Equity (PE) or infrastructure strategies and other predominantly non-MiFID financial instrument strategies. This is a very significant concession won by lobbying efforts from the PE industry and effectively exempts such firms from the MiFID2 research rules.

provided guidance that firms can accept transaction reporting offered by a broker as part of the execution service provided to its clients, provided that this (i) does not influence best execution and (ii) is offered as a standard term of business by the broker (e.g., it is not selectively provided for free to some firms but not others) and

stated that that US brokers are in discussion with the US Securities and Exchange Commission (SEC) to explore the potential for arrangements that would allow US broker dealers to accept research payments by EU firms once MiFID II applies from 03 January 2018. It is not yet clear whether this will provide a solution to the issues but the FCA states that it will continue to monitor the situation and, if necessary, provide an update in the future.

(Note, also, ESMA’s guidance in respect of inducements, research and RPAs in its ‘Questions and Answers: On MiFID II and MiFIR investor protection topics’, published on 06 June 2017.)

(b) Inducements – charging

The FCA is broadly speaking, proceeding with its general inducements proposals (including the proposed “streamlining” approach alongside the UK’s existing adviser charging rules). In the PS, it has, however, set out a number of important confirmations/territorial limitations in this area. In particular:

- the extension of the MiFID2 inducement ban in respect of restricted advice will only apply where restricted advice is provided to retail clients in the UK
- the ban on firms that provide independent or restricted advice or portfolio management services to retail clients from accepting and rebating monetary benefits to such clients (which the FCA considers to be a necessary alignment with the existing RDR) will mirror the scope of the UK adviser charging rules, so will only apply where the retail client is in the UK
- as a result
- firms which provide independent advice or portfolio management services to retail clients outside the UK will be subject to the same MiFID2 position as those which provide independent advice or portfolio management services to professional clients and
- firms which provide restricted advice to retail clients outside the UK will be subject to the MiFID2 inducement rules as they apply to firms with the exception of those providing portfolio management or independent investment advice (as is the case for firms providing restricted advice to professional clients)
- the existing RDR adviser charging rules will be retained, despite the introduction of the new MiFID2 inducements rules, but will continue to have a different scope from that of the MiFID requirements. RIPs which fall within MiFID will be subject to both MiFID2 and RDR rules – but the RDR rules will, however, be amended to:
- clarify that the inducements ban applies to any inducements received in connection with a firm’s business of providing advice, and not merely in relation to specific personal recommendations and
- confirm that only minor non-monetary benefits can be accepted in relation to advice on retail investment products (RIPs), whether or not these fall under MiFID
- the FCA is likely to consult again on its proposal to apply the inducements ban more widely to the business of providing advice – for both RIPs (under the RDR rules) and MiFID products which are not RIPs – probably in a forthcoming consultation paper dealing with the consequential changes arising from the Regulated Activities Order (RAO) changes. Firms should bear in mind, as a separate matter to the PS, HM Treasury’s proposals to alter the scope of the ‘advising on investments’ regulated activity (under Article 53(1) of the RAO)
- the FCA’s new rules will not affect the provisions in COBS 6 on continued payment of trail commission and the FCA has introduced a new transitional provision to make clear that the new MiFID2 requirements in COBS 2.3A apply only to inducements which are paid, provided or received in respect of services that are provided to clients on or after 03 January 2018. The FCA emphasises the point that it is the date on which the service is provided which is relevant, not the date on which the relevant commercial relationship is initiated
- as expected, there will be no extension of the ban on receiving and rebating monetary benefits in relation to services to professional clients, although the FCA has reiterated its practical view (which, perhaps, implies that it might take a less permissive view at a later date) that firms could take the commercial decision not to accept and rebate third party payments in relation to professional clients, so as to apply consistent standards across the business
- the FCA’s rules are being finalised on the basis that Article 3 firms1 will be subject to the same requirements in relation to inducements as MiFID firms.

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1 Article 3 of MiFID allows Member States to exempt from authorisation as MiFID investment firms, those firms which (i) provide investment advice and/or receive and transmit orders, (ii) do not hold client funds or securities, (iii) only receive and transmit client orders for transferable securities and collective investment schemes units and/or provide related investment advice, and are only allowed to transmit such orders to identified firms or funds and (iv) do not do MiFID business outside their home Member State. Firms exempted under Article 3 must be subject to national regulation. Article 3(2) of MiFID2 requires such regulation to be ‘at least analogous’ to the provisions in respect of authorisation and supervision, conduct of business and organisational requirements.
there is currently no proposal to require firms to comply with the adviser charging rules for advice on structured deposits – although the MiFID2 inducement rules will apply to firms when selling, or advising on, a structured deposit

the FCA has built into the wording of the inducements rule the presumption, under Article 24(9) of MiFID2, that a firm which fails to comply with the inducements rule is to be regarded as not having fulfilled its obligations in relation to conflicts of interest and the requirement that firms must act honestly, professionally and in accordance with the best interests of the client.

(c) Client categorisation
Taking into account industry feedback to its original proposals, the FCA has modified its approach to the reclassification of local authority clients and will continue to exercise its discretion to introduce additional or alternative quantitative opt-up criteria.

The key points to note are that the FCA has:
- introduced a fourth quantitative categorisation criterion, namely that the local authority uses investment services as part of the administration of a pension fund within the local government pension scheme (LGPS)
- reduced the portfolio threshold size for the quantitative test to £10 million (from a proposed £15 million)
- confirmed that the opt-up test must be run separately on a local authority’s treasury management function and its pension fund administration
- re-iterated that, where a UK firm has a client which is a non-UK local authority, it should defer to the local criteria deemed appropriate for local government in the territory in which the authority is located. If the relevant Member State has not exercised its discretion to apply a different standard from the test set out in MiFID2, the UK firm should use the basic opt-up quantitative test (set out in Annex II (II.1) of MiFID2) rather than the FCA’s enhanced opt-up test
- permitted firms flexibility to opt-up clients before 03 January 2018 rather than wait until that date before commencing the process – this is despite the lack of transitional provisional provisions in this area at the European level.

Overall, for the pension fund administration arm of local authorities, the FCA’s enhanced quantitative test is likely to be straightforward to satisfy. The qualitative test, though, remains a challenge.

For the treasury management function, the reduction of the portfolio threshold to £10 million in the quantitative test is helpful but the remaining limbs of the quantitative test (10 trades of a significant size per quarter over the past four quarters or 12 months’ experience in the financial sector for at least one year in a professional position) will continue to be difficult to meet. The qualitative test is likely to be more straightforward since the underlying asset classes and range of investment services used by local authorities are likely to be less complex than those used with pension fund mandates.

(d) Disclosure requirements and other conduct issues (excluding client categorisation)
Complaints handling
In the PS, the FCA confirms that it does not intend to extend either (a) the MiFID2 complaints handling rules to all complaints or (b) the remit of the Financial Ombudsman Service to handle complaints from professional clients and eligible counterparties (ECPs) unless they are consumers or small businesses.

Costs and charges
The FCA has also noted that:
- it is not (for the time being, at least) proposing to publish a standardised reporting format which sets out how firms should calculate and disclose point-of-sale and post-sale information, including information on costs and charges. The FCA will, however, continue to engage with any industry-led development of a standardised format
- it will not impose more detailed costs and charges disclosures on firms carrying out non-MiFID business. However, a firm which is carrying out both MiFID and non-MiFID business may consider adopting the MiFID2 standards in relation to its non-MiFID business, provided that the firm is satisfied that (a) this imposes a standard equivalent to, or higher than, that the non-MiFID disclosure requirement that would otherwise apply and (b) compliance with the MiFID disclosure requirement would also comply with the non-MiFID requirement which would otherwise apply.

(e) Independence, Suitability and Appropriateness
Independence
- MiFID2 introduces a European-wide standard for ‘independent advice’ for the first time, although the concept has been a feature of the UK advice market for several years pursuant to the RDR. There is little practical difference between these two independence standards
- MiFID2 requires firms which describe their advice as ‘independent’ to assess a sufficient range of financial instruments, which are sufficiently diverse in terms of their type and issuers or product providers to ensure they suitability meet the client’s objective, and not be limited to investments issued or provided by closely linked entities
a new requirement under MiFID2 is that firms which offer investment advice on an independent and restricted basis must, in good time prior to providing the service
  - inform clients in a durable medium whether the advice will be independent or restricted
  - present itself as independent for the services for which it provides investment advice on an independent basis and
  - have adequate systems and controls in place to ensure both types of advice services and advisers are separated from each other so that clients are not likely to be confused about the advice they are receiving

Importantly, an individual adviser cannot provide both independent and non-independent advice

the FCA notes in the PS that it recognises that the MiFID2 requirement preventing an adviser providing both independent and restricted advice is likely to be an issue for firms which give both types of advice and will present particularly difficulties for firms that have only one adviser. However, as this requirement is stipulated in the Delegated Regulation, it is directly applicable and the FCA must implement it. However, the FCA is seeking to limit the impact of the provision by not applying it more broadly to non-MiFID firms and will allow advisers who do not advise on MiFID financial instruments or structured products to continue to provide both independent and restricted advice

the FCA has adopted the MiFID2 independence standard and added the guidance to COBS 6.2B which it put forward in CP 16/29 to help firms demonstrate that they are meeting the MiFID ‘independence’ standard consistently

the new MiFID2 independence standard will be applied to MiFID financial instruments and structured deposits. It will also apply to other non-MiFID RIPS (such as insurance-based investments and personal pensions) but only when advising retail clients in the UK

accordingly, for advice that falls outside of scope of MiFID2 (with certain limited exceptions), the FCA will apply as rules the MiFID2 independence provisions from the Delegated Regulation - this is relevant to non-MiFID firms (including Article 3 firms) and MiFID firms which provide advice to retail clients on RIPS which are not MiFID financial instruments

the FCA notes that respondents to CP 16/29 agreed with this approach as it helps maintain consistent regulatory standards while avoiding complexity and potential consumer confusion.

Suitability

The suitability requirements in the FCA’s final rules, which apply to entities providing investment advice or portfolio management services, show little change from the equivalent provisions in MiFID1. In essence, these require firms to obtain necessary information on (i) a client’s knowledge and experience in the relevant investment field, (ii) the client’s financial situation and (iii) the client’s investment objectives, in order to enable advisers to make a recommendation or take a decision to trade which is suitable for that client.

Points of note within the PS include:
  - certain aspects of the suitability requirements may be assumed for professional clients (which continues under MiFID2)
  - MiFID2 expands on the existing suitability provisions and adds some new requirements (e.g., when advice or discretionary services involve switching investments the firm must collect information on the client’s existing investments and the recommended new investments in order to analyse the costs and benefits of the switch in order to enable the firm reasonably to demonstrate that the benefits of switching are greater than the costs)
  - the FCA will include the new requirements in a separate chapter of COBS (COBS 9A for MiFID business) leaving the current requirements in place for non-MiFID business pending consultation on the Insurance Distribution Directive
  - the COBS 9A requirements will apply to Article 3 firms. There is no gold-plating of these requirements in relation to other types of entities
  - the FCA notes in the PS that it received requests for guidance from trade bodies on the costs and benefits to be assessed on switching (see above) as well as other suitability requirements contained in Delegated Regulations (which are directly applicable leaving no scope for FCA interpretation).
  - In response, the FCA notes that ESMA is in the process of updating its existing suitability guidelines – as part of this work, on 13 July 2017, ESMA published a consultation paper, “Guidelines on certain aspects of the MiFID II suitability requirements”. The consultation period closes on 13 October 2017 and ESMA intends to publish a Final Report in Q1 or Q2 2018.

Appropriateness

the FCA has made no substantive changes to the rules proposed in CP16/29 and will include the new provisions for MiFID products in a new chapter of COBS, COBS 10A. Current rules in COBS 10 will continue to apply to a non-MiFID firm in particular circumstances

the new MiFID2 provisions are not being gold-plated in respect of non-MiFID firms

the appropriateness test (for non-advised sales) must be carried out when a firm executes, or receives and transmits, a client order in relation to a complex product (there being a distinction under MiFID between ‘complex’ and ‘non-complex’ products). Firms must obtain information regarding their client’s experience and knowledge in order for the firm to assess if the products and services envisaged are appropriate. For professional clients, this can be assumed while the test does not apply to eligible counterparty clients

MiFID2 narrows the scope of products deemed automatically non-complex, with the result that the appropriateness test must be carried out in relation to a wider range of products
in addition, under MiFID2 firms are now required to record the results of an appropriateness test, including when a warning has been given but the client wishes to proceed with the transaction regardless and whether the firm decided to carry out the client’s request in spite of its warning. Such warnings have always been required to be given but recording them is now mandatory.

the FCA has confirmed that the distributor is responsible for ensuring compliance with the relevant appropriateness rules – under the finalised rules in the FCA’s Product Intervention and Product Governance Sourcebook (PROD), a distributor must understand the financial instruments which it distributes to clients and assess the compatibility of financial instruments with the needs of the client. Separately, the PROD rules note that the distributor must have in place procedures and measures to ensure that, when deciding the range of financial instruments and investment services to be distributed and the target market, all applicable rules are complied with, including those in respect of appropriateness.

the FCA has stood by its original view that investment trusts and non-UCITS retail schemes (NURS) are neither automatically non-complex nor automatically complex but must be assessed against the criteria set out in the MiFID2 Delegated Regulation and that firms should adopt a cautious approach if there is any doubt as to whether a financial instrument in non-complex.

(f) Dealing and Managing

Points to note within the PS are as follows:

- **Best execution** – the FCA has confirmed that it will not now (as it had proposed in CP 16/29) apply MiFID2 best execution rules to full-scope UK AIFMs “at the current time”. Such AIFMs will continue to be subject to the existing best execution standards set out in the AIFMD Delegated regulation and supplemented by COBS 18.5.4AR (although this rule will become COBS 18.5A.8R).

- **Best execution** - the FCA has, though, confirmed that it will extend best execution requirements to cover a broader range of firms than is strictly required under MiFID2, including: non-MiFID business, Article 3 firms (excluding obligations under RTS 28), UCITS management companies, small authorised AIFMs and operators of residual CIS.

- **Client Order handling** - the rules now apply to firms advising on or selling structured deposits and the FCA has provided guidance on additional methods for making client limit orders public with the choice of venue to be determined by a firm’s execution policy.

- **Transaction record keeping** - the rules relating to client orders, decisions to deal and limit order publication transactions now apply to Article 3 firms which provide investment advice. The rules in relation to client orders and limit order publication transactions which apply to MiFID investment firms will now apply to UK branches of third country firms.

- **Personal account dealing** - these provisions are extended to investment firms or credit institutions selling or advising clients in relation to structured deposits.

(g) Underwriting and placing and Investment Research

**Underwriting and placing**

- the FCA has maintained the approach it set out in the CP of largely copying out the requirements in MiFID2 in relation to underwriting and placing but extending these requirements to capture UK branches of third country (non-EU) firms with the aim of maintaining “a level playing field between MiFID firms and third country firms”.

- the FCA noted its view that the MiFID2 obligations regarding underwriting and placing are broadly consistent with existing FCA guidance in the Handbook.

- the FCA has retained the definition of “corporate finance contact” in its final rules, thereby allowing a firm which carries out placing not to treat end investors in any placement as clients of the firm, subject to certain specified conditions. There had been concern in DCM and ECM spheres that the extended definition of executing orders (to include acquiring securities at the point of their issuance) could result in an extension of conduct duties to placees, even if they were not strictly a “client” for MiFID2 purposes.

**Investment Research**

In implementing the MiFID2 requirements regarding the production of investment research, the FCA has performed a general copy-out of the MiFID2 rules, with the exception of extending the requirements to capture UK branches of third country firms, energy market participants, oil market participants and Article 3 firms.

There are no substantive changes between the draft rules proposed in the CP as compared to the final rules in the PS. However, the following points should be noted:

- although MiFID2 contains several new rules regarding investment firms producing investment research which do not appear in MiFID1, the majority of these are already to be found in the FCA’s COBS, with the notable exception of the following:
  - the requirement for firms to introduce physical separation between financial analysts involved in the production of investment research and other relevant persons and
  - the application, in MiFID2, of certain conflict of interest requirements to producers of non-independent research.
in response to a request from respondents to the CP for further guidance on the latter point, FCA cautions in the PS that it is “ultimately for firms to make judgement on circumstances when it might not be proportionate to maintain physical separation of analysts” and points firms to the obligations under SYSC 10.2.

(h) Product Governance

As a general point, the PS places repeated emphasis on the principle of proportionality, including in respect of discretionary investment management (DIM), ECP business and extraterritoriality.

It should be noted, however, that the FCA has gold-plated the MiFID2 requirements so that the provisions set out in Chapter 3 of PROD apply as guidance to all non-MiFID firms. So, for example, an AIFM or UCITS ManCo which falls within the new FCA Glossary definition of ‘manufacturer’, (i.e., “a firm which creates, develops, issues, and/or designs investments, including when advising corporate issuers on the launch of new investments”) will need to take into account the FCA’s guidance in PROD 3.

The PS notes in respect of ESMA’s Final Report, “Guidelines on MiFID II product governance requirements” (published on 02 June 2017) that the FCA will consider what further steps it needs to take to address the Guidelines as part of the UK’s overall product governance regime.

The FCA also comments that PROD will apply to firms providing portfolio management since this investment service is within the definition of ‘distributing’ and there is no provision to allow an exemption. As mentioned above, the FCA emphasises that firms should apply the relevant requirements in a manner which is both proportionate and appropriate to the underlying service.

In light of feedback received from industry, the FCA has made a number of amendments to the product governance requirements in PROD from those on which it consulted.

The key points to note are the following:

- the deletion of the guidance at draft PROD 3.2.12G that manufacturers should ensure that a product’s complexity is a reasonable match to the sophistication and understanding of the identified target market
- the deletion of the proposed gold-plated guidance at draft PROD 3.2.15G, which listed factors that manufacturers should take into account when conducting scenario analysis. The FCA highlights, however, that the guidance of its precursor, the FSA, including around stress testing, in the Retail Product Development and Governance – Structured Product Review (FG 12/09) remains relevant for firms developing structured products
- as has been widely discussed, Article 30(1) of the Level 1 text of MiFID2 dis-applies Article 24(2) (but not Article 16(3)) in respect of ECP business. The FCA’s original draft of PROD did not reflect this but, in the final rules, the FCA has now dis-applied the distributor obligations at PROD 3.3.1R (which tracks article 24(2) MiFID) in respect of ECP business, thereby aligning PROD with MiFID2
- the FCA has reworded the responsibility of the compliance oversight function in order to make the language in PROD (at 3.2.32R and 3.3.20R) consistent with that in the MiFID II Delegated Directive – the relevant person must ‘monitor’ rather than ‘oversee’ product governance arrangements, in order to detect any risk of failure to comply with PROD.

(i) Knowledge and Competency requirements

Article 25(1) of MiFID2 introduces a requirement that firms ensure that individuals providing advice or information to clients possess the necessary knowledge and competence to enable the firm’s MiFID2 investor protection obligations to be met.

In the PS, the FCA has:

- generally copied out the detailed requirements in MiFID2, based on both the provisions of Article 25(1) and of ESMA’s “Guidelines for the assessment of knowledge and competence” (published on 03 January 2017)
- retained the existing requirements in its Training and Competence sourcebook (TC), which generally go beyond the minimum requirements contained in the ESMA Guidelines
- added new requirements into TC 4 and into Chapter 5.1.5AA to AE of its Systems and Controls Sourcebook (SYSC) to reflect two new MiFID2 requirements. These changes introduce requirements for relevant individuals to (a) have obtained at least 6 months’ appropriate experience and (b) acquire the necessary knowledge and competence within a maximum of 4 years (after which they may no longer provide those activities under supervision).

There are no applicable transitional arrangements, so firms must be in a position to comply with the guidelines by 03 January 2018.

(j) Recording of telephone conversations

MiFID II provides, for the first time, an EU-wide harmonising ‘taping’ requirement (i.e., to record telephone conversations and electronic communications) in respect of firms providing client order services (related to the reception, transmission and execution of client orders), as well as dealing on own account.
the FCA considers that for UK firms, the new requirements should not prove significantly more prescriptive or costly than its existing regime for those already in scope.

it proposed, in CP 16/29, (a) to extend the rules on taping to capture collective portfolio management activity, the activities of Article 3 firms, such as those carrying out corporate finance business and retail financial advisers and (b) to remove the current conditional exemption for DIM services under the existing domestic regime.

in the PS, the FCA has confirmed that its rules on taping will apply in relation investment activities specified under SYSC 10A, not only to MiFID firms but also to collective portfolio managers, including AIFMs, UCITS ManCos, as well as Article 3 firms, UK branches of third country firms and energy and oil market participants.

other than this gold-plating of scope, the FCA’s requirements in this area do not go beyond those required under MiFID2.

for non-MiFID firms which are currently subject to the taping rules, the scope of relevant instruments is to be reduced to exclude financial instruments not linked to trading on a trading venue.

as a result, for AIFMs such as those managing PE, real estate, infrastructure, private debt, or other AIFs which do not invest in MiFID instruments, there will be no taping requirement in respect of this business. This is another significant concession for PE funds.

The FCA has also confirmed that:

- it will remove the exemption from the taping rules for firms providing DIM services and
- retail financial advisory firms will be subject to the ‘at least analogous’ taping requirement (by either taping or making written notes of relevant conversations)
- certain corporate finance business communications will be in scope, if communications occur in the process of providing relevant client order services and own account dealing (such as, for example, conversations between a bank and buyers relating to the re-selling of shares purchased by an underwriting bank when underwriting an issue of securities).

The FCA has largely followed the amendments to its Supervision Manual (SUP) which it set out in PS17/5.

However, some limited changes relate to the transitional periods for passport notifications under MiFID2:

- the FCA will stop receiving passport notifications under MiFID1 from 04 December 2017.
- the transitional provisions for firms to submit MiFID2 passporting notifications start from 31 July 2017.
- however, the FCA will now start receiving MiFID2 passporting notifications via the FCA Connect system from 04 December 2017, unless the firm cannot submit via this system, in which case firms will still be able to submit by email until 02 January 2018. This includes where firms wish to obtain a passport:
  - for an investment service or financial instrument to which MiFID2 will apply, but to which MiFID does not apply (e.g., emissions allowances);
  - for an investment service or financial instrument introduced by MiFID2 (e.g., operating an OTF), prior to the application date of MiFID2.
- those who are currently exempt from MiFID1 but will cease to be exempt under MiFID2 (e.g., commodity derivative dealers, who will not be able to rely on the ancillary business exemption) and who wish to obtain such a passport, will be required to submit the notification by email, presumably because such persons are unlikely to have access to the FCA’s Connect system.

Conclusion

In the introduction to this note, we observed that the primary areas of interest in the PS relate to (i) gold-plating of MiFID2 requirements onto a wider scope of firms than mandated by MiFID2 and (ii) the retention of local UK-specific conduct regimes.

In particular, following the publication of this PS, we now have a much clearer idea of the ways in which MiFID2 will apply to different categories of investment manager (MiFID firms, AIFMs, and UCITS ManCos). While the FCA has pushed ahead with its proposal to gold-plate the phone taping, inducements and product governance rules to all categories of investment manager, there are now key distinctions between the MiFID regime, on the one hand, and the AIFMD and UCITS regimes on the other hand. In particular, AIFMs and UCITS ManCos are not subject to transaction reporting and post-trade transparency and (following this PS) AIFMs are not subject to the MiFID2 best execution rules, including the “Top 5” execution venue publication rules. This is a significant development and may present opportunities for regulatory arbitrage between the regimes.
It is also helpful now to have clarity from the FCA on those areas of existing UK standards and policies, where the FCA is retaining a regime which goes beyond MiFID. This includes the FCA’s confirmation about its retention of the RDR rules and their interaction with the MiFID inducements rules, and the retention of the UK’s training and competence rules.