

EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES AND MARKETS ACT 2000 (MARKETS IN
FINANCIAL INSTRUMENTS) (MODIFICATION OF POWERS) REGULATIONS
2006

2006 No. 2975

1. Introduction

1.1 This explanatory memorandum has been prepared by Her Majesty's Treasury and is laid before Parliament by Command of Her Majesty.

2. Description

2.1 These Regulations amend UK financial services legislation as part of giving effect in the UK to the EC's Markets in Financial Instruments Directive ("the directive").¹ The amendments principally expand the powers of the UK's financial services regulator, the Financial Services Authority ("the FSA"), and broaden the Treasury's powers to make regulations governing recognised investment exchanges, such as the London Stock Exchange and the London Metal Exchange.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative background

4.1 The directive does three main things. It:

- establishes organisational requirements and rules governing behaviour towards investors for firms ("investment firms") who wish to be authorised to undertake activities linked to the buying and selling of financial instruments such as shares, bonds and derivatives;
- sets a regulatory framework for stock and derivative exchanges and other markets where the organised trading of financial instruments takes place;
- facilitates the carrying on of business by investment firms and stock and derivative exchanges and other organised financial markets across national borders in Europe.

4.2 The directive replaces the Investment Services Directive² ("the ISD"). Under new arrangements for financial services legislation in the EU, additional detailed

¹ Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (OJ No. L145, 30.4.2004, page 1).

² Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (OJ L141, 11.6.93, page 27)

provisions were passed under powers in the directive ("the implementing directive"³ and "the implementing regulation"⁴). The UK is required to give effect to the directive in its national law by 31 January 2007 and the measures must come into force on 1 November 2007.

4.3 Some provisions of the directive are already given effect in the UK by existing legislation and FSA rules, but changes are needed to give full effect to the directive. In addition to these regulations, other statutory instruments giving effect to the directive should be laid before Parliament before the end of 2006, and the FSA should finalise changes to its rules before the end of January 2007.

4.4 The regulations amend various aspects of the Financial Services and Markets Act 2000 ("FSMA") to broaden the FSA's and Treasury's powers. The regulations need to be in force before the main regulations giving effect to the directive in the UK can be laid because aspects of those regulations are dependent upon the extension of the Treasury's powers in these regulations.

4.5 A transposition note setting out how the main elements of the directive are given effect to in legislation and FSA rules will be made available when the other regulations implementing the directive are laid.

4.6 An explanatory memorandum on the Commission's proposal for a directive was approved by the Scrutiny Committee in the House of Lords on 27 January 2004 and the Scrutiny Committee in the House of Commons on 22 January 2003.

5. Extent

5.1 These regulations apply to all of the United Kingdom.

6. European Convention on Human Rights

6.1 The Economic Secretary to the Treasury has made the following statement under section 19(1)(a) of the Human Rights Act 1998: "In my view the provisions of the Financial Services and Markets Act 2000 (Markets in Financial Instruments) (Modification of Powers) Regulations 2006 are compatible with the Convention rights."

7. Policy Background

7.1 The intention of the directive is to encourage the creation of deep and liquid capital markets in the EU and to ensure investors are adequately protected so that they can invest with confidence. As such, the directive was a key element in the EU's Financial Services Action Plan ("the FSAP") a legislative programme which was designed to make a significant step forward towards establishing a single market in financial services in Europe. The Government endorsed the FSAP.

³ Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC (OJ No. L241, 2.9.2006, page 26)

⁴ Commission Regulation (EC) No 1281/2006 of 10 August 2006 implementing Directive 2004/39/EC (OJ No. L241, 2.9.2006, page 1)

7.2 The European Commission decided that the directive's predecessor, the ISD, needed to be replaced for two main reasons. Firstly, because it had been ineffective in promoting business across national borders in Europe. Second, because it did not cover important financial services activities such as investment advice and the trading of commodity derivatives.

7.3 In changing legislation to give effect to the directive in the UK, the Treasury has tried to use, as much as possible, language from the directive itself to avoid adding additional obligations on UK businesses. Where the words from the directive have not been copied out this has largely been to ensure a coherent fit with existing provisions.

7.4 The main changes in the regulations are:

- **Regulations 3 and 14:** Broadening the FSA's powers to make rules protecting the interests of consumers under s138 of FSMA in respect of ancillary services provided by firms within the scope of the directive. Ancillary services are services the provision of which do not automatically require a firm to be authorised under the directive, but which if a firm is authorised under the directive it is permitted to provide across national borders in addition to the core services which require authorisation. They are set out in Section B of Annex 1 of the directive.
- **Regulations 4 and 14:** The directive requires all communications, including marketing communications, to be fair, clear and not misleading. The FSA does not currently have the power to impose such an obligation on all marketing communications made by investment firms. Regulation 4 extends its rule-making powers to enable it to do so and regulation 14 enables it to consult on the rule change before these regulations come into force.
- **Regulations 5, 6, 7 and 15:** Under the directive, regulators like the FSA can stop a firm from outsourcing decisions about how a client's investments should be managed, such as which investments to buy and sell and when, to a firm based outside of the European Economic Area. Regulators must provide guidance to firms about the circumstances in which such a veto will be exercised. There is no such specific obligation currently placed on the FSA and these amendments therefore introduce one. They also enable the FSA to consult on the guidance before these regulations come into force.
- **Regulation 8:** The directive requires certain information to be made publicly available by stock exchanges about the prices investors are willing to buy and sell shares at ("pre-trade transparency") and the details of transactions which have been completed ("post-trade transparency"). However, in certain circumstances the directive allows, at the discretion of the regulator, pre-trade transparency obligations to be waived and post-trade transparency obligations to be deferred. This regulation provides the Treasury with the powers to include in regulations provisions allowing the FSA to exercise the discretion to grant waivers and deferrals from transparency obligations.
- **Regulation 10:** For the purposes of FSMA it is necessary to have a definition of an investment firm to ensure that obligations stemming from the directive are

correctly applied. It is not possible to do this by simply referring to the definition in the directive because the application of the definition is effectively modified by other provisions of the directive, in particular those setting out exemptions from the directive.

7.5 The Treasury ran a public consultation on the legislative changes necessary to implement MiFID between the middle of December 2005 and the end of March 2006. A copy of a feedback statement on the consultation will be available on the EU financial services section of the Treasury's website (www.hm-treasury.gov.uk) when the rest of the implementing regulations are laid.

7.6 The responses to the consultation touched only on one issue of relevance to these regulations. This was the amendments to the FSA's powers to make rules covering financial promotions made by investment firms. The amendments to section 145 of FSMA in regulation 4 deal with this issue. The directive requires the FSA to have broader powers to make rules covering financial promotions. Some respondents to the consultation would have liked the broadening of the FSA's powers in this area to cover areas of business and firms not covered by the directive in order to simplify the FSA's rules. It was decided that it was not appropriate to use regulations under the European Communities Act to extend the FSA's powers in such a way, and so the amendments only broaden the FSA's powers in respect of firms caught by the directive.

7.7 The FSA is responsible for regulating all firms covered by the directive. It is therefore leading on ensuring that the relevant firms are aware of the changes being made. But in addition, Treasury officials have spoken at numerous industry conferences and seminars on the directive, and provided regular e-mail updates to the main trade associations whose members are affected by the directive and to individual firms.

8. Impact

8.1 A regulatory impact assessment on the implementation of the directive will be attached as an annex to the explanatory memorandum to regulations dealing with the rest of the implementing legislation.

8.2 As now, the FSA will be responsible for enforcement of FSMA. The implementation of the directive should not significantly impact on the size of their task. Public sector organisations will, as they do at the moment, have to ensure that they comply with FSMA and FSA rules if applicable.

9. Contact

9.1 Sarah Parkinson at HM Treasury: Tel 020 7270 5912 or e-mail: sarah.parkinson@hm-treasury.x.gsi.gov.uk can answer any queries regarding the regulations.