

EXPLANATORY MEMORANDUM TO
THE FINANCIAL SERVICES AND MARKETS ACT 2000 (REGULATED
ACTIVITIES) (AMENDMENT) ORDER 2017

2017 No. 488

1. Introduction

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

2. Purpose of the instrument

- 2.1 This Order amends the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (S.I. 2001/544) (“the RAO”) to transpose parts of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (recast) (OJ L173, 12/6/2014, p.349) (“MiFID II”). In particular, a new specified activity of operating an organised trading facility (“OTF”) is created; certain derivatives relating to currencies, binary contracts and emission allowances are added as specified investments; and the specified activities of dealing in investments as agent (article 21 of the RAO), arranging deals in investments (article 25 of the RAO), managing investments (article 37 of the RAO) and advising on investments (article 53 of the RAO) are applied in relation to structured deposits.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None.

Other matters of interest to the House of Commons

- 3.2 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland and Northern Ireland.

4. Legislative Context

- 4.1 The RAO specifies kinds of activities and investments for the purposes of the Financial Services and Markets Act 2000 (c.8) (“FSMA”). When an activity of a specified kind is carried on by way of business in relation to an investment of a specified kind, it is a “regulated activity” for the purposes of the Act. Section 19 of that Act prohibits persons from carrying on any regulated activity in the United Kingdom unless they are authorised or exempt.
- 4.2 The RAO is amended to include new specified activities and investments in order to transpose MiFID II. MiFID II replaces and extends 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, p.1) (“MiFID I”). Among many other changes, MiFID II applies to a slightly wider range of investment services and activities than MiFID I, including operating an OTF. It also adds new financial instruments, in particular emission allowances, and a wider range of currency derivatives. Article 1.4

of MiFID II extends certain requirements to firms selling or advising on structured deposits.

- 4.3 This Order also makes some minor technical amendments (principally to the RAO) for the purposes of Directive 2011/61/EU of the European Council and of the Parliament of 8 June 2011 on Alternative Investment Fund Managers (OJ L 174, 1.7.2011, p. 1).
- 4.4 MiFID II, like MiFID I, is largely transposed through FSMA, subordinate legislation under that Act and rules made by the regulators under that Act. Consequently it is necessary to extend the activities and investments covered by that Act to reflect the wider scope of MiFID II.
- 4.5 Prior to agreement in Council, MiFID II was submitted to Parliament for scrutiny. It was cleared by the House of Lords European Scrutiny Committee on 27 February 2013, and was cleared by the House of Commons Scrutiny Committee after a debate on the same day.
- 4.6 MiFID II was the subject of the House of Lords European Union Committee's second report of the 2012-13 session (HL28), "*MiFID II: Getting it Right for the City and EU Financial Services Industry*". The report was debated in a Motion to Take Note, moved by Lord Harrison on 26 March 2013 (Hansard volume 744). In its response, the government welcomed the report, and set out how it would take the recommendations forward.
- 4.7 Two further statutory instruments will be required for the transposition of MiFID II: the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017 and the Data Reporting Services Regulations 2017. HM Treasury expects to lay these shortly.
- 4.8 A transposition note showing how this Order transposes MiFID II is published on legislation.gov.uk.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is the United Kingdom.
- 5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

- 6.1 The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2017 are compatible with the Convention rights."

7. Policy background

What is being done and why

- 7.1 The instrument forms part of the transposition into UK law of MiFID II. MiFID II and the corresponding Market in Financial Instruments Regulation ("MiFIR") (OJ L 173, 12.6.2014, p. 84) update MiFID I in light of the financial crisis and technological change.

- 7.2 MiFID II and MiFIR create more robust and efficient market structures, and require more trades to be conducted through trading venues in order to promote transparency. They will introduce new safeguards for algorithmic and high frequency trading, and improve competition in essential post-trade services such as clearing. They will provide a stricter framework for commodity derivatives and strengthen investor protection. The aims of the EU legislation are consistent with our overall approach to the regulation of financial markets in the UK.
- 7.3 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.
- 7.4 MiFID II applies to a wider range of investment services and activities than MiFID I, expanding the regulatory perimeter. As such, it is necessary to ensure that all of the activities specified in MiFID II are covered by FSMA.
- 7.5 The Order amends the RAO to provide that operating an OTF is a regulated activity. An OTF is a platform on which multiple third parties interested in buying and selling bonds, structured finance products, emission allowances or derivatives are able to interact, leading to transactions in the financial instrument. However, in contrast to a multilateral trading facility, which was defined in MiFID I, and where the operator of the platform plays a neutral role in bringing about transactions, the operator of an OTF plays an active role in bringing together buying and selling counterparties and helping them to negotiate the terms of a trade. This will often involve voice trading where the operator contacts counterparties by telephone or electronic communications to develop a transaction.
- 7.6 The Order amends the RAO to provide that structured deposits are within the scope of certain specified activities. Structured deposits are deposits with interest rates derived from or based on a single security, a basket of securities, an index, a commodity, debt insurance or a foreign currency. The interest is paid (or not paid) depending on the performance of the underlying.
- 7.7 The Order makes emission allowances a specified investment. An emission allowance is the tradable unit under the European Union Emissions Trading Scheme, giving the holder the right to emit one tonne of carbon dioxide, or the equivalent amount of two more powerful greenhouse gases, nitrous oxide and perfluorocarbons.
- 7.8 The Order also makes amendments for the purposes of Article 6(4) of Directive 2011/61/EU of the European Council and of the Parliament of 8 June 2011 on Alternative Investment Fund Managers to extend the scope of activities in which an alternative investment fund manager may engage, bringing them into line with the equivalent services in MiFID II.
- 7.9 It also brings the regulation of binary options and other fixed outcomes derivatives within the scope of financial services legislation. The effect of that is to transfer regulation of those derivatives from the Gambling Commission to the Financial Conduct Authority (“FCA”). The government believes 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.

- 7.10 The Order replaces references in the RAO to the Commission Regulations under MiFID I with references to the equivalent provisions in Commission Regulations under MiFID II. The Commission Regulations contain additional conditions applying to some of the MiFID II financial instruments and additional explanation of the MiFID II definition of “investment advice”. The Order also updates the RAO Schedules which for convenience set out the texts of the MiFID II financial instruments, investment services and activities and exemptions.

Consolidation

- 7.11 There are no current plans to consolidate the legislation amended by this instrument.

8. Consultation outcome

- 8.1 The Treasury ran a public consultation on the transposition of MiFID II which opened on 27 March 2015 and closed on 18 June 2015. The consultation focussed on the regime for firms from non-EU countries; data reporting services providers; position limits and reporting in commodity derivatives; the regime for unauthorised persons; the regulation of structured deposits; the ability of regulators to remove board members; OTFs; and binary options.
- 8.2 The Treasury received over 30 responses to the consultation document. It has examined and considered each carefully.
- 8.3 Respondents broadly or unanimously agreed with the Treasury’s proposed approach.
- 8.4 Where there was confusion about definitions or rules, the Treasury, in liaison with the European Commission, has provided clarification.
- 8.5 Respondents did not wholly agree with the government’s proposals around the criminal offences regime for operators of data reporting services providers, which will be transposed in the forthcoming Data Reporting Services Regulations 2017. The government has carefully considered whether it is proportionate to create offences akin to sections 89 and 90 of the Financial Services Act 2012 (which relate to giving misleading statements or impressions) in relation to market manipulation by data reporting services providers. On balance, the Government agrees with respondents that it would not be proportionate to create new offences in this respect.
- 8.6 Respondents highlighted that the amendments to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (“FPO”) (S.I. 2005/1529) did not necessarily ensure consistency between it and the RAO in relation to structured deposits. The government welcomed this response and revised the amendments to the FPO accordingly, in order to fully reflect the RAO activity that has been turned on in relation to structured deposits.
- 8.7 A more detailed analysis of the consultation outcome and the Treasury's policy response to the opinions expressed can be found at:
<https://www.gov.uk/government/consultations/transposition-of-the-markets-in-financial-instruments-directive-ii>.

9. Guidance

- 9.1 It is not considered necessary to issue specific guidance in connection with this Order.
- 9.2 The Treasury has had extensive informal engagement with industry representatives during the negotiation and implementation phases of MiFID II.

10. Impact

- 10.1 The Treasury assessed the impact on business, charities or voluntary bodies resulting from the transposition of MiFID II in its consultation stage impact assessment, which was published on 25th March 2015. The Estimated Annual Net Cost to Business was calculated at £105.2 million.
- 10.2 The impact on the public sector will be located in three areas. The possible increase in costs of financial transactions stemming from MiFID II, which may affect the public sector, will be covered in the final stage impact assessment. The Treasury does not anticipate that there will be any direct impact on central government or the Bank of England in their transactions in financial markets. The Treasury is working closely with representatives from local government and the FCA in order to mitigate the possible effect on local government's participation in financial markets.
- 10.3 An Impact Assessment is submitted with this memorandum and is published alongside the Explanatory Memorandum on the legislation.gov.uk website.

11. Regulating small business

- 11.1 The Order applies to activities that are undertaken by small businesses to the extent that they are investment firms or otherwise caught. However, the Treasury expects the impact on small and micro-business to be relatively light, as set out in the consultation stage impact assessment.

12. Monitoring & review

- 12.1 The instrument contains a requirement for the Treasury to review the legislation, every five years, and set out the conclusions of each review in a published report. The first report, to be published in the five year period beginning from 1st April 2017, will set out the objectives intended to be achieved by the regulatory provision.

13. Contact

- 13.1 Mark Griffin at HM Treasury Telephone: 020 7270 6651 or email: Mark.Griffin@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.