



# HM TREASURY

## INFORMAL CONSULTATION FOR:

### Client Classification transitionals as part of implementation of MiFID

HM Treasury is proposing to introduce Regulations in relation to firms' client classification limitations. The terminology under MiFID, as you will be aware, differs from that currently used. While MiFID offers some transitionals to ease the process of moving from a to b, we believe that legislation could make this process simpler and more robust for firms and the FSA.

We therefore attach draft legislation for your comment. The intent of this Regulation is primarily to map firms' current client classification limitations across to the equivalent new MiFID categories. For example: if you currently are limited to dealing with private clients, then the legislation will amend your permission to allow you to deal with retail clients. No action is required from you for this mapping to take effect and the FSA intend to update the register so that you can see your revised permissions as of 1<sup>st</sup> November. If you wish to alter your client limitations you can of course do so in the usual way by applying for a variation of permission pursuant to section 51 FSMA.

The mapping will apply to MiFID and some non-MiFID business (broadly other 'designated investment business' as defined in the FSA Handbook and accepting deposits). A limited number of firms will not be automatically mapped if they have a limitation that only allows them to deal with market counterparties. The FSA is dealing with these firms separately (as outlined in the recent FSA "MiFID Permissions and Notifications Guide").

We considered various alternatives for delivering this outcome (set out in more detail in the attached partial Regulatory Impact Assessment<sup>1</sup>) and the proposed legislation seems to minimise the cost on industry and the FSA.

The draft Regulation also covers some non-MiFID firms including firms falling within the article 3 MiFID exemption for receivers and transmitters and advisers. In its recent consultation paper "Conduct of Business regime: non-MiFID deferred matters" (CP 07/9), the FSA published further proposals relating to client classification and non-MiFID business. These include proposals whereby the boundary between "retail" and "professional" firms will be similar to the existing boundary between "private" and "intermediate" customers and a transitional regime to help smooth further the transition from the old categories to the new. Further information is provided in the FSA's "MiFID Permissions and Notifications Guide".

The draft Regulations also make technical amendments to the services and activities transitionals that were contained in the Financial Services and Markets Act (Markets

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<sup>1</sup> We have carried out a partial regulatory impact assessment because of the minor nature of this proposal and because it sits within the framework of the main MiFID implementation.

in Financial Instruments) Regulation 2007<sup>2</sup>. These changes amend and extend our domestic transitionals in light of the recently agreed CESR mapping process. While not a direct part of this consultation, views would of course be welcomed.

We would welcome comments on the attached draft legislation from a broad range of market participants, including MiFID and non-MiFID firms. The legislation is designed to dovetail with the FSA's work in the area of client classification to date.

Any comments would be welcomed, in particular:

- 1) Do you agree that this legislation will be helpful in easing the implementation of MiFID?
- 2) Is the scope of the legislation sufficiently clear?
- 3) Is the commencement date helpful?
- 4) Any other comments

This is an informal consultation because the process builds on existing MiFID consultation and in view of the time constraints. We would welcome feedback by **12<sup>th</sup> July**. Please send your comments to Sarah Parkinson at HMT, either by post (1 Horse Guards Road, SW1A 2HQ) or email ([sarah.parkinson@hm-treasury.x.gsi.gov.uk](mailto:sarah.parkinson@hm-treasury.x.gsi.gov.uk)).

This consultation will be available on the HMT MiFID website and is being sent directly to those parties that have previously expressed an interest in MiFID issues. Responses will be subject to the following confidentiality provisions<sup>3</sup> and a summary of the responses will be on the HMT website in due course.

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<sup>2</sup> SI 2007/126.

<sup>3</sup> Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations).

If you want the information that you provide to be treated as being confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request to disclose the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.

HM Treasury will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

# **PARTIAL REGULATORY IMPACT ASSESSMENT FOR:**

## **Client Classification transitionals as part of implementation of MiFID.**

### **Purpose and intended effect of measure**

#### *Objective*

2. MiFID was passed in April 2004 and is due to come into effect on 1 November 2007. It is a directive dealing with the buying and selling of shares, bonds, money market instruments, units in collective investment undertakings and derivatives, and the regulation of the markets where financial instruments are traded. It replaces the Investment Services Directive (“ISD”)<sup>4</sup>. MiFID is part of the EU’s Financial Services Action Plan (“FSAP”) which is aimed at integrating Europe’s capital markets to bring down the cost of capital and facilitate enhanced growth and employment. The UK transposed the main MiFID implementing legislation in January 2007.

3. The Commission recognised that firms would face challenges in moving from ISD to MiFID and so MiFID contained certain transitional provisions to ease that process. We have identified a further area where a transitional would be helpful. The proposed legislation would provide a mapping from the client types that firms are currently allowed to deal with, to the new client classifications that are introduced by MiFID. This issue was only covered for *existing* clients in the transitionals contained within MiFID (and transposed by FSA rules) and so does not provide a future proof solution.

#### *Background*

4. MiFID categorises clients into three types (retail, professional and eligible counterparty) and distinguishes between them in terms of client protections – with the most protective regime reserved for retail clients. This is similar in principle to the current UK regime, but we have different terminology (private, intermediate and market counterparties) and slightly different criteria for allocating individuals to a particular class (so, for example, more clients are likely to be classed as retail than were previously classed as private).

5. Post MiFID the UK will change its terminology to use that adopted by MiFID, for simplicity the same terms will be used for most non-MiFID business but there may be slight differences in how customers are allocated to the categories. The FSA consulted extensively with firms on this approach and it was deemed simpler to bring most business onto the same framework (these change will not affect those limitation types relating broadly to insurance mediation activities, other than life business, and home finance activities).

6. UK firms typically have a limiting constraint placed on their permission that says which sorts of customers they can deal with. This means, for example, that if only

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<sup>4</sup> Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (OJ L141, 11.6.93, page 27).

allowed to deal with market counterparties, they would not be able to deal with private customers unless they upgraded their internal systems and sought approval from the FSA via an application for variation of permission.

7. MiFID provides that firms can treat most *existing* clients as falling within the equivalent new categories but does not speak to new clients. This would mean that a UK firm with a current permission to deal with intermediate clients would be allowed to continue dealing with those clients under the new professional regime. However, they would not necessarily be able to take on all *new* professional clients. This issue arises because the definitions do not overlap perfectly.

8. The solution to this is to update firms' permissions to ensure that the old terms are replaced by the new MiFID terms. There are a variety of ways in which this could be done, this consultation seeks views on whether we have identified the most efficient way of delivering this change.

#### *Rationale for government intervention*

9. FSA and firms cannot simplify the change to firms' permissions without legislative support because the normal process is set out in FSMA and hence cannot be altered without HM Treasury involvement.

#### **Consultation**

10. We are consulting primarily via the MiFID standing group (which brings together trade associations, firms, lawyers and other affected parties) with whom we have shared many MiFID documents. The consultation will also be on the HMT website and publicised by the FSA and HMT through a variety of MiFID meetings and documents.

11. Given that the proposal merely builds on existing legislation and the time constraints, this is an informal consultation of four weeks.

#### **Options**

##### *Option 1 – FSA uses its powers*

12. FSA could review and alter all existing regulatory permissions to replace the current UK terms with the new MiFID terms (eg to replace private clients with retail clients). There is a formal procedure for this sort of amendment to firms' permissions that cannot be (without legislation) circumvented. FSA would therefore need a process for identifying and writing to all the firms concerned, the firms would then need to allocate time and resources to considering the issue and potentially responding.

##### *Option 2 – introduce the proposed measures*

13. The proposed legislation would mean that the current client limitations in firms' permissions would acquire the equivalent MiFID meanings. The FSA then plan to update their database to replace the current terminology with the MiFID terms. Firms that wanted to seek an alteration to their client limitations would have opportunity to do so via the usual variation of permission route. The timing of this legislation is

designed to ensure that firms have clarity about their mapped permissions in time to assess whether they wish to alter their permissions ahead of November 2007.

*Option 3 – firms request alterations to their permissions*

14. If neither FSA nor HMT take any action then firms will need to request alterations to their permissions. This would involve considerable effort by firms to prepare the requests and the FSA to process them.

**We recommend Option 2. This provides maximum simplicity for the firms and FSA.**

**Costs and Benefits**

*Option 1 – FSA uses its powers*

15. Some 7000 or so firms would be affected. FSA would need to write to each, the firms would then need to review the letter. We estimate firms will spend on average 2 hours considering the correspondence from the FSA and 5 hours for those firms with the more complex limitation type of “intermediate customers and market counterparties”. Therefore the aggregate cost across the industry will be material – potentially some £2.5 million. FSA would then need to update all register entries and handle any technical questions – a similar exercise suggests that some 10% of firms would contact the FSA.

*Option 2 – introduce the proposed measures*

16. FSA would need to do some general promotional work to ensure firms were aware of what was happening and to highlight the opportunity to request a change to their client limitations. This would form part of their general MiFID promotional work and so would have marginal additional cost. FSA would need to alter the register. This approach should yield some minor savings to FSA relative to Option 1 of some £100,000.

17. Firms would need to consider the effect of the legislation and whether they were content with the new scope of their client limitations. Because the legislation offers a simpler, more robust solution than an FSA approach we expect firms would require less time to consider the change. The benefits to firms relative to Option 1 could be in the region of £1 million pounds.

18. Time and effort at HM Treasury in drafting and consulting on the legislation. This is unlikely to be significant.

*Option 3 – firms request alterations to their permissions*

19. Firms would need to write to FSA requesting a change to their permission. FSA would need to review and respond to the requests. The FSA would also still need to do some general promotional work to ensure firms were aware of what was happening and applied in good time to make the necessary changes. This would be a large exercise with significant costs for FSA and firms.

**Option 2 provides savings to firms and the FSA that could be in the region of £1 million pounds. We therefore recommend Option 2.**

### **Small firms Impact Test**

20. Small firms may be more likely to find managing regulatory change difficult. The proposed regulation would smooth the process of the change from ISD to MiFID and may therefore be of particular benefit for small firms.

### **Competition Assessment**

21. This should have no appreciable impact on competition as the benefits will be available to all firms.

### **Enforcement, sanctions and monitoring**

22. This legislation would have no impact on enforcement, sanctions and monitoring. Firms would be able to alter the effect of the mapping by applying for a variation of permission in the normal way.

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STATUTORY INSTRUMENTS

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**2007 No.**

**FINANCIAL SERVICES AND MARKETS**

**The Financial Services and Markets Act 2000 (Markets in  
Financial Instruments) (Amendment No. 2) Regulations 2007**

*Made* - - - - \*\*\*

*Laid before Parliament* \*\*\*

*Coming into force* - - - in accordance with regulation 1(2)

The Treasury are a government department designated<sup>(5)</sup> for the purposes of section 2(2) of the European Communities Act 1972<sup>(6)</sup> in relation to investment firms and to the provision of investment services;

The Treasury make these Regulations in exercise of the powers conferred on them by section 2(2) of that Act:

**Citation and commencement**

**1.**—(1) These Regulations may be cited as the Financial Services and Markets Act 2000 (Markets in Financial Instruments) (Amendment No. 2) Regulations 2007.

(2) These Regulations come into force—

- (a) for the purposes of regulation 7A of the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2007<sup>(7)</sup> (inserted by regulation 2(4)) on 15th August 2007;
- (b) for the purposes of enabling notice to be given in accordance with regulation 9E(3) of those Regulations (inserted by regulation 2(5)), on 15th August 2007, and
- (c) for all other purposes, on 1st November 2007.

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<sup>(5)</sup> S.I. 1993/2661.

<sup>(6)</sup> 1972 c.68; section 2(2) was amended by section 27 of the Legislative and Regulatory Reform Act 2006 (c. 51). By virtue of the amendment of section 1(2) made by section 1 of the European Economic Area Act 1993 (c. 51) regulations may be made under section 2(2) to implement obligations of the United Kingdom created by or arising under the Agreement on the European Economic Area signed at Oporto on 2nd May 1992 (Cm 2073, OJ No L 1, 3.11.1994, p. 3) and the Protocol adjusting that Agreement signed at Brussels on 17th March 1993 (Cm 2183, OJ No L 1, 3.1.1994, p. 572). For the decision of the EEA Joint Committee in relation to Directive 2004/39/EC, see Decision No 65/2005 of 29th April 2005 (OJ No L 239, 15.9.2005, p.50).

<sup>(7)</sup> S.I. 2007/126 amended by S.I. 2007/763.

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**Amendment of the transitional provisions in the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2007**

2.—(1) The Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2007 are amended as follows.

(2) After regulation 6 insert—

**“Transitional provisions: EEA investment firms exercising passport rights under the investment services directive**

**6A.**—(1) Where on or before 31st October 2007 an EEA investment firm has exercised an EEA right deriving from the investment services directive to establish a branch or to provide services in the United Kingdom, and the Authority has received in respect of that firm—

- (a) a consent notice under paragraph 13(1) of Schedule 3 or a regulator’s notice under paragraph 14(2) of Schedule 3 in relation to an investment service specified in the first column in table 1 in Schedule 7 to these Regulations, or
- (b) notice of change under regulation 4(4) or 5(3) of the EEA Passport Rights Regulations in relation to an investment service specified in the first column in table 1 in Schedule 7 to these Regulations,

that notice is on 1st November 2007 to be treated as having been given in relation to the investment service or activity specified in the second column of table 1 opposite that investment service.

(2) Where on or before 31st October 2007 an EEA investment firm has exercised an EEA right deriving from the investment services directive to establish a branch or to provide services in the United Kingdom, and the Authority has received in respect of that firm—

- (a) a consent notice under paragraph 13(1) of Schedule 3 or a regulator’s notice under paragraph 14(2) of Schedule 3 in relation to a non-core service specified in the first column in table 2 in Schedule 7 to these Regulations, or
- (b) notice of change under regulation 4(4) or 5(3) of the EEA Passport Rights Regulations in relation to a non-core service specified in the first column in table 2 in Schedule 7 to these Regulations,

that notice is on 1st November 2007 to be treated as having been given in relation to the ancillary service specified in the second column of table 2 opposite that non-core service.

(3) Where on or before 31st October 2007 an EEA investment firm has exercised an EEA right deriving from the investment services directive to establish a branch or to provide services in the United Kingdom, and the Authority has received in respect of that firm—

- (a) a consent notice under paragraph 13(1) of Schedule 3 or a regulator’s notice under paragraph 14(2) of Schedule 3 in relation to the non-core service specified in paragraph 6 of Section C of the Annex to the investment services directive (investment advice concerning one or more of the instruments listed in Section B), or
- (b) notice of change under regulation 4(4) or 5(3) of the EEA Passport Rights Regulations in relation to the non-core service specified in paragraph 6 of Section C of the Annex to the investment services directive,

that notice is on 1st November 2007 to be treated as having been given in relation to the investment service specified in paragraph 5 of Section A of Annex I to the markets in financial instruments directive (investment advice).

(4) Where on or before 31st October 2007 an EEA investment firm has exercised an EEA right deriving from the investment services directive to establish a branch or to provide services in the United Kingdom, and the Authority has received in respect of that firm—

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- (a) a consent notice under paragraph 13(1) of Schedule 3 or a regulator's notice under paragraph 14(2) of Schedule 3 in relation to an instrument specified in the first column in table 3 in Schedule 7 to these Regulations, or
- (b) notice of change under regulation 4(4) or 5(3) of the EEA Passport Rights Regulations in relation to an instrument specified in the first column in table 3 in Schedule 7 to these Regulations,

that notice is on 1st November 2007 to be treated as having been given in relation to the financial instrument specified in the second column of table 3 opposite that instrument.

(5) If this regulation conflicts with any law of an EEA investment firm's home state, the law of the firm's home state shall prevail.

(6) In this regulation—

“EEA right” has the meaning given in paragraph 7 of Schedule 3;

“EEA investment firm” means an EEA firm falling within paragraph 5(a) of Schedule 3 (before its amendment by these Regulations);

“home state” in relation to an EEA investment firm means the EEA State which is the firm's home Member State for the purposes of the markets in financial instruments directive.”.

(3) In paragraph (3) of regulation 7 omit the words from “and the ancillary service” to the end of the paragraph.

(4) After regulation 7 insert—

### **“Transitional provision: investment research and financial analysis**

**7A.**—(1) This regulation applies where a UK investment firm on or before 15th August 2007 has given—

- (a) notice of intention under paragraph 19(2) or 20(1) of Schedule 3, or
- (b) notice of change under regulation 11(3) or 12(2)(a) of the EEA Passport Rights Regulations,

in relation to the non-core service specified in paragraph 6 of Section C of the Annex to the investment services directive.

(2) The Authority may on or before 31st October 2007 give notice to the UK investment firm's host state regulator (within the meaning of paragraph 11 of Schedule 3) that from 1st November 2007 the firm will offer the ancillary service specified in paragraph 5 of Section B of Annex I to the markets in financial instruments directive (investment research and financial analysis).

(3) Regulation 11 or 12 of the EEA Passport Rights Regulations does not apply where the Authority has given a notice in accordance with paragraph (2).

(4) Where the UK investment firm concerned gave written notice to the Authority on or before [31st August 2007], this regulation shall not apply to him.”.

(5) After regulation 9D insert—

### **“Transitional provision in relation to client classification**

**9E.**—(1) Any person who immediately before 1st November 2007 had a Part IV permission containing a limitation—

- (a) in relation to the carrying on of any regulated activity except an activity mentioned in paragraph (2); and
- (b) described by reference to a category of clients specified in the first column in the table in Schedule 9,

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is from 1st November 2007 to be treated as having a Part IV permission to carry on that regulated activity subject to the same limitation described by reference to the category of clients specified in the second column of that table opposite.

(2) The activities are—

- (a) an insurance mediation activity (within the meaning given by paragraph 2(5) of Schedule 6 to the Act) carried on in relation to a contract of insurance (within the meaning given by article 3(1) of the principal Order) which is not a life policy (within the meaning of the Glossary (Conduct of Business and Other Sourcebooks) Instrument 2007 (2007/32) made by the Authority under the Act on 24th May 2007); and
- (b) activities of the kind specified in any of the following provisions of the principal Order—
  - (i) article 25A (arranging regulated mortgage contracts),
  - (ii) article 25B (arranging regulated home reversion plans),
  - (iii) article 25C (arranging regulated home purchase plans),
  - (iv) article 53A (advising on regulated mortgage contracts),
  - (v) article 53B (advising on regulated home reversion plans),
  - (vi) article 53C (advising on regulated home purchase plans),
  - (vii) article 61 (entering into and administering regulated mortgage contracts),
  - (viii) article 63B (entering into and administering regulated home reversion plans), and
  - (ix) article 63F (entering into and administering regulated home purchase plans).

(3) Where the person concerned gave written notice to the Authority on or before 1st October 2007 to that effect, paragraph (1) shall not apply to him.”.

(6) In Schedule 7—

- (a) for the shoulder note substitute “Regulation 6A and 7”;
- (b) in the fourth entry in the first column of table 1, for “discriminatory” substitute “discretionary”.

(7) After Schedule 8 insert—

“SCHEDULE 9

Regulation 9E

TRANSITIONAL PROVISION IN RELATION TO CLIENT CLASSIFICATION

<i>Category of clients in limitation in Part IV permission immediately before 1st November 2007</i>	<i>Category of clients in limitation in Part IV permission from 1st November 2007</i>
Private customers only	Retail clients only
Intermediate customers only	Professional clients only
Private and intermediate customers only	Retail and professional clients only
Intermediate customers and market counterparties only	Professional clients and eligible counterparties”.

[date]

*name*  
*name*

Two of the Lords Commissioners of Her Majesty’s Treasury

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### EXPLANATORY NOTE

*(This note is not part of the Regulations)*

These Regulations, which amend the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2007 (S.I. 2007/126) (“the principal Regulations”), implement in part Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (OJ No L 145, 30.4.2004, p.1) (“the Directive”). The Directive is also implemented by other statutory instruments including the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment No. 3) Order 2006 (S.I. 2006/3384) and by the Financial Services Authority (“the FSA”) using powers under the Financial Services and Markets Act 2000 (c. 8) (“the Act”).

Regulation 2(2) inserts transitional provision into the principal Regulations for investment firms authorised in other EEA States exercising the right to provide services or establish a branch in the United Kingdom similar to the transitional provision in regulation 7 of the principal Regulations for UK investment firms. This transitional provision enables an investment firm to continue to provide the same investment services in the United Kingdom on and after 1st November 2007 (the date on which the Directive has effect) without the need for any action on the part of a firm, its home State competent authority or the FSA. The transitional provision will not apply where it conflicts with any law in the home State of the investment firm.

Regulation 2(4) partially replaces the transitional provision made in the principal Regulations for UK investment firms authorised to passport the non-core service of investment advice under Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (OJ No L 141, 11.6.1993, p. 27). Unless they opt out, investment firms authorised to passport this service will, from 1st November 2007, be authorised to passport under the Directive the ancillary service of investment research and financial analysis where the FSA has notified the competent authority of the State concerned.

Permissions under Part 4 of the Act of firms authorised to carry on activities regulated under the Act in the United Kingdom often contain a limitation under section 42(7)(a) of the Act as to the category of clients in relation to which the activities can be carried on. The Directive introduces new categories of clients for investment firms (retail clients, professional clients and eligible counterparties) which differ slightly from the categories currently used in relation to investment and other firms in the United Kingdom. Regulation 2(5) and (7) contain transitional provision to amend the permissions under Part 4 of the Act of investment firms and certain other types of firms so that “client category” limitations refer to the categories specified in the Directive, without the need for the firm to make an application or for the FSA to amend the permission. There is provision for a firm to opt out of the amendment to its permission by giving notice to the FSA.

The Regulations also make minor amendments to regulation 7 of the principal Regulations (transitional provision in relation to United Kingdom investment firms exercising passport rights under the investment services directive) and to Schedule 7 to the principal Regulations (exercise of passport rights under the investment services directive).

A transposition note has been prepared which sets out how the main elements of the Directive are transposed into United Kingdom law. A Regulatory Impact Assessment of the effect of this instrument and the other instruments transposing the Directive on the costs of business has been prepared. Both may be obtained from the Financial Services Strategy Team, HM Treasury, 1 Horse Guards Road, London SW1A 2HQ. They are also available on HM Treasury’s website ([www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)). Copies of both documents have been placed in the libraries of both Houses of Parliament.