



Now Let's Focus Again

Since November 2007, many UK firms have been complying with MiFID but the regulation will be creating more waves in 2008 as the Financial Services Authority turns its attention to firms outside the directives scope.

The Markets in Financial Instruments Directive (MiFID) came into force in the UK on 1 November 2007, but it is continuing to generate considerable interest and activity. The FSA's focus has now turned on firms outside the directive's scope. These firms face further MiFID-related regulatory developments, above all the proposed extension of the 'common platform' rules.

Meanwhile, UK firms caught by MiFID are already preparing to be assessed in their first year of MiFID compliance. The delay in implementing MiFID across the European Economic Area (EEA) may also cause problems for firms who have investment activities outside the UK.

Non-MiFID Firms: Common Platform and Conduct of Business

For non-MiFID firms more generally, there are two key issues to focus on in 2008:

1. Expansion of the common platform

First, non-MiFID firms face the possible expansion of the 'common platform', a proposal affecting up to 18,000 firms, including operators of funds, insurance intermediaries and mortgage brokers.

The common platform is a set of rules introduced by the Financial Services Authority (FSA) in 2006 to reflect the systems and control requirements of MiFID and the Capital Requirements Directive (CRD). They apply to firms affected by one or both of those directives; these firms have become known as 'common platform firms'. This new regime came fully into force on 1 November, at the same time as MiFID itself.

In December 2007, the FSA published CP07/23 'Organisational systems and controls - extending the common platform' addressing whether, for regulatory consistency, it should expand the application of these rules to include all non-MiFID firms except insurers.

The FSA's approach is to impose the high level requirements of the common platform as rules, with the more detailed material given the status of guidance. In the area of outsourcing, for example, the detailed requirements for outsourcing contracts are compulsory for MiFID firms but guidance only for most other firms. However, even though the new rules may not represent a significant change for most firms, they will still incur the expense of reviewing their systems to confirm that they comply with the new regime.



The main impact that the proposed expansion will have is in the area of conflicts of interest: non-MiFID firms may need to review their internal arrangements for addressing conflicts of interest to ensure they comply with the new rules. Above all, any firm that relies on disclosure to deal with conflicts must look to manage such conflicts internally, and rely on disclosure only as a last resort.

Following consultation, the FSA intends to implement these proposals on 1 October 2008.

2. FSA to adopt MiFID-based rules for conduct of business sourcebook

Secondly, in late 2007, the FSA announced that it was proceeding with its plan to adopt rules based on MiFID for large chunks of its conduct of business (COB) sourcebook (COBS). These will affect non-MiFID firms such as fund operators and depositaries. Under transitional provisions, these firms generally have until May 2008 to begin to comply with the new rules, and as MiFID regulated firms have found, this can often involve substantial internal changes.

Operators of Collective Investment Schemes

One type of firm outside the scope of MiFID is a collective investment scheme operator. For operators, there is one pressing issue which will be the subject of industry debate in 2008: whether they should owe a duty of best execution when dealing with applications to issue and redeem units or shares in the funds that it operates.

The FSA's previously issued consultation papers caused considerable confusion by suggesting that the FSA may require operators to start to provide best execution to investors in their funds. To the industry, this seemed an extraordinary proposal. Old COB included an exemption from the best execution regime when dealing with a purchase or sale of units in a fund from its operator. The FSA proposed to remove this rule, but without explaining how it expected operators to provide MiFID-style best execution for investors.

The FSA was subsequently forced to accept that more thought was required on this issue, and announced that the COB exemption would remain until 1 November 2008 under COBS transitional provisions. It also announced that it would conduct a cost/benefit analysis on its proposal and seek the views of the industry to decide on a way forward. Most in the industry hope that they will be able to persuade the FSA to make this transitional provision permanent, but firms affected by this issue should ensure that they get involved in industry lobbying.

MiFID Firms: A Post MiFID Programme

What should UK firms caught by MiFID do next? They should conduct a review of their MiFID systems and documentation in 2008 to pick up any gaps



or weaknesses in the MiFID implementation project. They may not have managed to cover all areas in the project before the 1 November deadline; for example, on issues such as their broker terms of business or outsourcing agreements. Mopping up these remaining areas should be a priority.

Companies must also begin their periodic reviews of their new MiFID based policies and procedures. Most importantly, this includes those prepared for the FSA's new rules on conflicts of interest and best execution. These must be considered and refreshed, and amended if necessary, and any initial problems ironed out. You should also gather management information (MI) as evidence that the policies are operating effectively.

Finally, you should keep an eye on any comments from the FSA. Even though MiFID has been fully implemented in the UK, the FSA may continue to publish guidance on MiFID related issues in 2008. Such guidance might be issued to clarify the FSA's position as to how the new rules apply (e.g., in the vexed area of transaction reporting). It might also help address any teething problems that become apparent in the new regime. Although not always binding, in that it will not have the status of rules or guidance under the FSA Handbook, informal material such as this can provide a useful insight into how the FSA interprets its rules, and what it expects from firms.

MiFID Firms: European Operations

For MiFID firms with European operations, the issue of how to grapple with the directive has been complex and at times torturous. The UK was the first and only state in the EEA to comply with the 31 January 2007 deadline for implementing the directive. One of the newest member states, Romania, was close behind, publishing its final rules in February. Ireland then followed with rules published in March. Elsewhere, however, compliance has been patchy and some states are still lagging behind; most notably Poland, the Czech Republic and Spain.

So, how do UK firms with European operations proceed? Do they implement MiFID rules across their entire EEA operations, or for those countries that are still lagging behind, do they wait and see how the rules are introduced into local law?

In practice, most in the industry expect that regulators across various jurisdictions will take a common sense approach during the 'settling down' period. Some regulators have expressed sympathy with the tight timetables and challenging work programmes that firms have experienced, indicating that they will not be going out of their way to punish firms that did their best in difficult circumstances.

But this does not remove the risk that different jurisdictions or regulators may have taken different approaches on various issues when introducing MiFID, despite the directive's intention to harmonise matters.



For a UK firm with substantial EEA operations it is obviously desirable to have (to the extent possible) a single set of operational processes and procedures, and a single approach to compliance. MiFID is expected to reduce the risk that firms will have to do different things when conducting MiFID business in different EEA countries, but it cannot completely obviate it. A UK firm operating in another EEA country will therefore still have to obtain local advice (taking a risk based approach) to identify any key differences between how local law has implemented MiFID and the UK approach.

FSA Priorities

A final note for all firms, whether MiFID or non-MiFID, is to be conscious of what the FSA regards as its own regulatory priorities for 2008. To date, the FSA has indicated that for MiFID firms, these include the following:

- Firms dealing with wholesale clients should focus particularly on best execution, client categorisation and investment research issues.
- Firms dealing with retail clients should focus on client-facing documentation (e.g. terms of business, financial promotions etc.), suitability/appropriateness tests and the disclosures required under the inducements rules.

More generally, the FSA is likely to place firms' attitudes to treating customers fairly under closer scrutiny. By March 2008 firms should have appropriate management information or measures in place to test whether they are treating their customers fairly and, by the end of the year, all firms should be able to demonstrate to the FSA that they are consistently treating their customers fairly.

The FSA is due to publish its business plan for 2008/9 in February 2008. All firms should pay close attention to any new areas of regulatory focus.