PERIMETER GUIDANCE (MiFID AND RECAST CAD SCOPE) INSTRUMENT 2007

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of the power in section 157(1) (Guidance) of the Financial Services and Markets Act 2000.

Commencement

B. This instrument comes into force on 1 November 2007.

Amendments to the Perimeter Guidance manual (PERG)

C. PERG is amended in accordance with the Annex to this instrument. The general guidance in PERG does not form part of the Handbook.

Citation

D. This instrument may be cited as the Perimeter Guidance (MiFID and Recast CAD Scope) Instrument 2007.

By order of the Board
22 March 2007

Annex

Amendments to the Perimeter Guidance manual (PERG)

In this Annex, underlining indicates new text and striking through indicates deleted text, except where otherwise indicated.

1.4.2 G Table: list of general guidance to be found in *PERG*.

Chapter:	Applicable to:	About:
PERG 13: Guidance on the scope of the Markets in Financial Instruments Directive and the recast Capital Adequacy Directive ~~[to be issued]~~	Any *UK person* who needs to know whether *MiFID* or the recast CAD as implemented in the UK apply to him.	the scope of *MiFID* and the recast CAD

After PERG 12 insert the following new chapter. The inserted text is not underlined.

13. Guidance on the scope of the Markets in Financial Instruments Directive and the recast Capital Adequacy Directive

13.1 Introduction

The purpose of this chapter is to help UK firms consider:

- whether they fall within the scope of the Markets in Financial Instruments Directive 2004/39/EC ('MiFID') and therefore are subject to its requirements;
- how their existing *permissions* correspond to related MiFID concepts;
- whether the recast Capital Adequacy Directive ('recast CAD') applies to them; and
- if so, which category of investment firm they are for the purposes of the FSA transposition of the recast CAD.

Background

MiFID replaces the Investment Services Directive (ISD). It expands the kinds of business which must be regulated in the UK to include, in particular, activities relating to a wider range of commodity and other non-financial derivatives. As a result of MiFID, the categories of firm which can exercise passporting rights and the categories of business for which the passport is available are wider than under the ISD. In particular, whereas investment advice was a non-core service under ISD, it is an investment service in its own right under MiFID and so can be provided on a cross-border basis as a standalone business.

MiFID is supplemented by "Level 2 measures", Commission Regulation (EC) No 1287/2006 (*MiFID Regulation*) and Commission Directive 2006/73/EC (*MiFID Implementing Directive*). These implementing measures amplify and supplement certain of the concepts and requirements specified in MiFID.

MiFID scope

The scope aspects of MiFID are primarily addressed through the *Regulated Activities Order* ('RAO') and *PERG* 2 focuses on the scope of *regulated activities* under the RAO and includes materials on the effect that MiFID has on the RAO. This chapter focuses more on the underlying MiFID investment services and activities, as well as the exemptions.

Where a firm's regular occupation or business is providing one or more *investment services* to third parties or performing investment activities in relation to MiFID financial instruments on a professional basis, it is a firm to which MiFID applies unless it is exempt.

Broadly, the exemptions from MiFID are likely to be relevant to insurers, group treasurers, professional firms to which Part XX of the *Act* applies, many *authorised professional firms*, professional investors who invest only for themselves, pension schemes, depositaries and operators of collective investment schemes or other collective investment undertakings (such as investment trusts), journalists, and commodity producers and traders. The exemptions are subject to conditions and limitations described in more detail below (see PERG 13.5).

The Treasury's implementation of the article 3 MiFID exemption is likely to be relevant to many financial advisers (see Q50) including some corporate finance advisers. It may also be relevant to some venture capital firms. The Treasury legislation enables firms falling within the scope of the exemption to elect to be subject to the requirements of MiFID and thereby acquire passport rights (see Q52).

In each case, it will be for firms and individuals to consider their own circumstances and consider whether they fall within the relevant exemptions. A firm which takes the benefit of one or more of the exemptions in article 2 or 3 MiFID may nevertheless require authorisation under the *Act* (see PERG 2).

In addition to investment firms, MiFID is also relevant to credit institutions providing investment services or performing investment activities (see Q5) and UCITS management companies to which article 5.4 *UCITS Directive* applies (in other words *UCITS investment firms*).

This guidance is concerned with the scope of MiFID and does not address the question of whether an investment firm that falls within the scope of MiFID is providing a MiFID investment service as opposed to an investment activity.

Recast Capital Adequacy Directive (recast CAD)

Investment firms subject to MiFID, including those who fall within the article 3 MiFID exemption but opt not to take advantage of it, and *UCITS investment firms* are subject to the requirements of the recast CAD. There are special provisions for certain commodities firms as well as firms whose MiFID investment services are limited to giving investment advice or receiving and transmitting client orders or both and who are not permitted to hold client money or securities.

Under the UK implementation of the recast CAD, the level of capital an investment firm subject to MiFID requires is determined by the type of investment services and activities it provides or performs, its scope of permission and any limitations or requirements attaching to that permission (see PERG 13.6). A firm relying on an article 2 or 3 MiFID exemption is not subject to the recast CAD.

How does this document work?

This document is made up of Q&As divided into the following sections:

- General (PERG 13.2);
- Investment services and activities (PERG 13.3);
- Financial instruments (PERG 13.4);
- Exemptions from MiFID (PERG 13.5);
- The recast CAD (PERG 13.6); and
- Flow charts, tables and lists (PERG 13 Annexes 1, 2, 3 and 4).

We have also included guidance in the form of flow charts to help firms decide whether MiFID and the recast CAD apply to them as well as permission maps indicating which regulated activities and *specified investments* correspond to MiFID investment services, activities and MiFID financial instruments (see PERG 13 Annexes 1, 2, 3 and 4).

Article and recital references are to MiFID (Level 1 measures) unless otherwise stated. References to categories of MiFID investment services and activities and MiFID financial instruments adopt the structure of Annex 1 MiFID: for example, A1 refers to "reception and transmission of orders in relation to one or more financial instruments" and C1 relates to "transferable securities".

13.2 General

Q1. Why does it matter whether or not we fall within the scope of MiFID?

Depending on whether or not you fall within the scope of MiFID, you may be subject to:

- domestic legislation implementing MiFID (for example, FSA rules);
- directly applicable legislation made by the European Commission (the *MiFID Regulation*); and
- domestic legislation implementing the recast CAD (see PERG 13.6).

The question is also relevant to whether you can exercise passporting rights in relation to investment services or activities - only firms to which MiFID applies can do so.

Q2. Is there anything else we should be reading?

The Q&As complement, and should be read in conjunction with, the relevant legislation and the general guidance on regulated activities, which is in chapter 2 of our Perimeter Guidance manual ('PERG'). The Q&As relating to the recast CAD should be read in conjunction with the relevant parts of our General Prudential sourcebook ('GENPRU') and the Prudential sourcebook for banks, building societies and investment firms ('BIPRU').

More generally, you should be aware that the recast CAD forms part of the Capital Requirements Directive ('CRD'), which also amends the Banking Consolidation Directive ('BCD').

Q3. How much can we rely on these Q&As?

The answers given in these Q&As represent the FSA's views but the interpretation of financial services legislation is ultimately a matter for the courts. How the scope of MiFID and the recast CAD affect the regulatory position of any particular person will depend on his individual circumstances. If you have doubts about your position after reading these Q&As, you may wish to seek legal advice. The Q&As are not a substitute for reading the relevant provisions in MiFID, the recast CAD, the MiFID implementing measures and The Treasury's implementing legislation, including the statutory instruments listed in Annex 4 ('Principal Statutory Instruments relating to MiFID scope issues').

Moreover, although MiFID and the recast CAD set out most of the key provisions and definitions relating to scope, some provisions may be subject to further legislation by the

European Commission. In addition to FSA guidance, MiFID's scope provisions may also be the subject of guidance or communications by the European Commission or the Committee of European Securities Regulators ('CESR'). Similarly, recast CAD provisions may be the subject of guidance or communications by the European Commission or the Committee of European Banking Supervisors ('CEBS').

Q4. We provide investment services to our clients – does MiFID apply to us?

Yes if you are:

- an "investment firm" and the exemptions in MiFID do not apply to you; or
- a "tied agent" as defined by MiFID.

If you are a non-EEA firm, for example the UK branch of a US firm, MiFID does not apply to you. However, if MiFID would have applied to you if you had been incorporated or formed in the EEA, you will be a *third country investment firm* under the FSA's rules. As a result, certain MiFID based requirements will apply to you.

See the flow charts in Annex 1 for further information and PERG 13.5 for guidance relating to exemptions. See Q7 and 8 for guidance on whether you are an investment firm and Q11 for guidance relating to tied agents.

Q5. We are a credit institution. How does MiFID apply to us?

If you are an EEA credit institution, article 1.2 MiFID provides that selected MiFID provisions apply to you, including organisational and conduct of business requirements, when you are providing investment services to your clients or performing investment activities. In our view, MiFID will apply when you are providing ancillary services in conjunction with investment services. Where you provide ancillary services on a standalone basis, MiFID will not apply in relation to those services. Article 1.2 MiFID is reflected in paragraph (2) of the *Handbook* definition of "MiFID investment firm".

Q6. We are a UCITS management company that, in addition to managing unit trusts and investment companies, provides portfolio management services to third parties. How does MiFID apply to us?

If you are the management company of a *UCITS scheme* with a permission to manage investments including MiFID financial instruments pursuant to article 5.3 *UCITS Directive*, certain MiFID provisions apply to you when you provide investment services to third parties (see article 5.4 *UCITS Directive*). These include initial capital endowment, organisational and conduct of business requirements. You are a *UCITS investment firm* for the purposes of the FSA Handbook. Article 5.4 *UCITS Directive* is reflected in paragraph (3) of the *Handbook* definition of "MiFID investment firm".

Q7. We provide investment services to our clients. How do we know whether we are an investment firm for the purposes of article 4.1(1) MiFID?

If your regular occupation or business includes the provision of investment services in relation to MiFID financial instruments to others on a professional basis, you are an investment firm and require *authorisation* unless you benefit from an exemption or are a tied agent (see Q11).

Where you are a firm with more than one business, you can still be an investment firm. We expect that the vast majority of firms which were subject to the requirements of the ISD are subject to MiFID requirements where they continue to provide the same investment services. We also expect some firms that were not subject to the ISD (for example, certain commodity dealers) to be investment firms for the purposes of MiFID and subject to MiFID based requirements. What amounts to a "professional basis" depends on the individual circumstances and in our view relevant factors will include the existence or otherwise of a commercial element and the scale of the relevant activity.

Q8. We do not provide investment services to others but we do buy and sell financial instruments (for example, shares and derivatives) on a regular basis. Are we an investment firm for the purposes of MiFID?

Yes, if you are trading in MiFID financial instruments for your own account as a regular occupation or business on a "professional basis". You can be an investment firm even if you are not providing investment services to others; this is a change from the position under the ISD, arising from the fact that you are also an investment firm under MiFID where you perform investment activities on a professional basis.

Even if you are an investment firm you may still be able to rely on one or more exemptions in article 2 MiFID, in which case MiFID will not apply (see PERG 13.5 and in particular article 2.1(d) (see Q40 and Q41)), 2.1(i) (see Q44 and Q45) and 2.1(k) (see Q46).

Q9. We are a credit institution that does not provide investment services to customers but we do have a treasury function. Are we subject to MiFID?

Not necessarily. Although you may be dealing on own account in relation to MiFID financial instruments, you may be able to rely upon the exemption in article 2.1(d) MiFID (see Q40). In our view, credit institutions can rely on exemptions in article 2 where they meet the conditions of the exemptions.

Q10. Is there any change to the "by way of business" test in domestic legislation?

There is no change to article 3 of the Financial Services and Markets Act 2000 (Carrying on Regulated Activities By Way of Business) Order 2001 as part of MiFID implementation by The Treasury, so the domestic test for whether you are carrying on 'regulated activities by way of business' and require *authorisation* remains unchanged.

Q11. How will we know whether we are a tied agent (article 4.1(25))?

A tied agent under MiFID is a similar concept to an *appointed representative* under the *Act*. A tied agent does not require authorisation for the purposes of MiFID, just as an *appointed representative* does not require *authorisation* under the *Act*. In our view, you will only be a tied agent if your principal is an investment firm (including a credit institution) to which MiFID applies. So, if you act for a principal that is subject to an exemption in either article 2 or 3 MiFID (as implemented by The Treasury – see Q48 and Q49), you are not a tied agent for the purposes of MiFID although you may be an *appointed representative* for domestic purposes. You will still not require authorisation under MiFID, either because you are not performing investment services and activities or, if you are, because you fall within an exemption in article 2 or 3 MiFID.

Assuming your principal is an investment firm to which MiFID applies, if you are registered as an *appointed representative* on the FSA Register and carry on the activities of *arranging (bringing about) deals in investments* or *advising on investments*, in either case in relation to MiFID financial instruments, you are likely to be a tied agent for the purposes of article 4.1(25).

It is possible for a UK representative to be a tied agent of an incoming EEA firm, in which case if the representative is established in the UK it will also be a branch of its principal. However, it is not possible for a tied agent to provide *investment services* on behalf of more than one investment firm to which MiFID applies.

Further material on *appointed representatives* and tied agents is contained in chapter 12 of our Supervision Manual ('SUP').

13.3 Investment Services and Activities

Q12. Where do we find a list of MiFID services and activities?

In Section A of Annex 1 to MiFID. There are eight investment services and activities in Section A (A1 to A8), four of which are further defined in article 4 MiFID. Those activities that are further defined are:

- investment advice (article 4.1(4) MiFID);
- execution of orders on behalf of clients (article 4.1(5) MiFID);
- dealing on own account (article 4.1(6) MiFID); and
- portfolio management (article 4.1(9) MiFID).

A further provision relating to investment advice is contained in article 52 of the *MiFID implementing Directive*.

Q13. When might we be receiving and transmitting orders in relation to one or more financial instruments? (A1 and recital 20)

Under the general definition of this service, you only provide the service if you are both receiving and transmitting orders. For example, this would be the case if you transmit subscription or redemption orders received from a client to the operator of a collective investment undertaking or transmit buy or sell orders to agency brokers.

This service though is also extended to include arrangements that bring together two or more investors, thereby bringing about a transaction between those investors. This meaning may be relevant, for example, to corporate finance firms. It could include, in our view, negotiating terms for the acquisition or disposal of investments on behalf of a corporate client with a potential buyer or seller, for example as part of a merger or acquisition. You may be providing this service even though, having brought the investors together, the actual offer or acceptance is not communicated through you.

The extended meaning of the service only applies if the firm brings together two or more investors and a person issuing new securities, including a collective investment undertaking, should not be considered to be an ‘investor’ for this purpose. This limitation does not apply though to the general definition of the service. Accordingly whilst an arrangement whereby a

person, on behalf of a client, receives and transmits an order to an issuer will, in our view, amount to reception and transmission, one in which it simply brings together an issuer with a potential source of funding for investment in a company, will not.

If you are party to a transaction as agent for your client or commit your client to it, you may be doing more than receiving and transmitting orders and will need to consider whether you are providing the investment service of executing orders on behalf of clients.

Q14. We are introducers who merely put clients in touch with other investment firms – are we receiving and transmitting orders?

No. If all you do is introduce others to investment firms so that they can provide investment services to those clients, this in itself does not bring about a transaction and so will not amount to receiving and transmitting orders. But if you are a person who does more than merely introduce, for example an introducing broker, you are likely to be receiving orders on behalf of your clients and transmitting these to clearing firms and therefore may fall within the scope of MiFID.

Q15. When might we be executing orders on behalf of clients? (A2, article 4.1(5) and recital 21)

When you are acting to conclude agreements to buy or sell one or more MiFID financial instruments on behalf of clients. You will be providing this investment service if you participate in the execution of an order on behalf of a client, as opposed simply to arranging the relevant deal. In our view, you can execute orders on behalf of clients either when dealing in investments as agent (by entering into an agreement in the name of your client or in your own name, but on behalf of your client) or, in some cases, by dealing in investments as principal (for example by back-to-back or riskless principal trading).

Q16. What is dealing on own account? (A3 and article 4.1(6))

Dealing on own account is trading against proprietary capital resulting in the conclusion of transactions in one or more MiFID financial instruments. In most cases, if you were a firm who was dealing for own account under the ISD, the FSA would expect you to be dealing on own account for the purposes of MiFID if you continue to perform the same activities.

Dealing on own account involves position-taking which includes proprietary trading and positions arising from market-making. It can also include positions arising from client servicing, for example where a firm acts as a *systematic internaliser* or executes an order by taking a market or 'unmatched principal' position on its books.

Dealing on own account may be relevant to firms with a *dealing in investments as principal* permission in relation to MiFID financial instruments, but only where they trade financial instruments on a regular basis for their own account, as part of their MiFID business. We do not think that this activity is likely to be relevant in cases where a person acquires a long term stake in a company for strategic purposes or for most venture capital or private equity activity. Where a person invests in a venture capital fund with a view to selling its interests in the medium to long term only, in our view he is not dealing on own account for the purposes of MiFID.

In our view, where you are a firm which meets all of the conditions of article 5.2 of the recast CAD (see Q61), you will not be dealing on own account.

Q17. What is portfolio management under MiFID? (A4 and article 4.1(9))

Portfolio management is managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more MiFID financial instruments. If there is only a single financial instrument in a portfolio, you may be carrying on portfolio management even if the rest of the portfolio consists of other types of assets, such as real estate. Portfolio management includes acting as a third party manager of the assets of a *collective investment scheme*, where discretion has been delegated to the manager by the operator of the scheme. In the case of management of a collective investment undertaking, however, an exemption may be available to the operator (see Q43). The advisory agent who keeps clients' portfolios under review and provides advice to enable the client to make investment decisions (but does not exercise discretion to take investment decisions himself) is not carrying on portfolio management but may be providing other investment services such as investment advice under MiFID.

Q18. What is investment advice under MiFID? (A5 and article 4.1(4))

Investment advice means providing personal recommendations to a client, either at his request or on your own initiative, in respect of one or more transactions relating to MiFID financial instruments.

Q19. What is a 'personal recommendation' for the purposes of MiFID (article 52 of the MiFID implementing Directive)?

A personal recommendation is one given to a person:

- in his capacity as an investor, or potential investor, or as agent for either which is:
    - presented as suitable for him or based on a consideration of his personal circumstances; and
    - constitutes a recommendation to him to do one or more of the following:
        - buy, sell, subscribe for, exchange, redeem, hold or underwrite a particular financial instrument;
        - exercise, or not to exercise, any right conferred by a particular financial instrument to buy, sell, subscribe for, exchange, or redeem a financial instrument.

This is similar to the UK regulated activity of *advising on investments* but is narrower in scope insofar as it requires the recommendation to be of a personal nature. A personal recommendation does not include advice given to an issuer to issue securities, as the latter is not an "investor" for the purposes of MiFID or article 53 of the RAO.

Q20. Can you give us some other practical examples of what are not personal recommendations under MiFID?

A recommendation is not a personal recommendation if it is issued exclusively through distribution channels or to the public (article 52 of the *MiFID implementing Directive*) and a 'distribution channel' is one through which information is, or is likely to become, publicly available because a large number of people have access to it. Advice about financial instruments in a newspaper, journal, magazine, publication, internet communication or radio or television broadcast should not amount to a personal recommendation for the purposes of MiFID (recital 79 to the *MiFID implementing Directive).*

Merely providing information to clients should not itself normally amount to investment advice. Practical examples include:

- advising clients on how to fill in an application form;
- disseminating company news or announcements;
- merely explaining the risks and benefits of a particular financial instrument; and
- producing league tables showing the performance of financial instruments against published benchmarks.

However, you should bear in mind that, where a person provides only selective information to a client, for example, when comparing one MiFID financial instrument against another, or when a client has indicated those benefits that he seeks in a product, this could, depending on the circumstances, amount to an implied recommendation and hence investment advice for the purposes of MiFID.

If you provide an investment research service to your clients or otherwise provide recommendations intended for distribution channels or the public generally, this is not MiFID investment advice (A5) although it may be an ancillary service (B5) for the purposes of MiFID and may also amount to the regulated activity of *advising on investments* for which you are likely to require *authorisation*.

Q21. Is generic advice investment advice for the purposes of MiFID (recitals 79 and 81 *MiFID implementing Directive*)?

No. Investment advice is limited to advice on particular MiFID financial instruments, for example "I recommend that you buy XYZ Company shares". If you only provide generic advice on MiFID financial instruments and do not provide advice on particular MiFID financial instruments, you are not a firm to which MiFID applies and do not require *authorisation*.

If you are an investment firm to which MiFID applies, however, the generic advice that you provide may be subject to MiFID-based requirements. For example, if you recommend to a client that it should invest in equities rather than bonds and this advice is not in fact suitable, you are likely, depending on the circumstances of the case, to contravene MiFID requirements to:

- act honestly, fairly and professionally in accordance with the best interests of your clients; and

- provide information to clients that is fair, clear and not misleading.

Q22. What is underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis? (A6)

A6 comprises two elements:

- the 'underwriting of financial instruments'; and/or
- the 'placing of financial instruments on a firm commitment basis'.

Underwriting is a commitment to take up financial instruments where others do not acquire them. In our view, placing is the service of finding investors for securities on behalf of a seller and may involve a commitment to take up those securities where others do not acquire them. We associate underwriting and placing of financial instruments with situations where a company or other business vehicle wishes to raise capital for commercial purposes, and in particular with primary market activity.

In our view, the 'firm commitment' aspect of the placing service relates to the person arranging the placing, as opposed to the person who has agreed to purchase any instruments as part of the placing. Accordingly, placing on a firm commitment basis occurs where a firm undertakes to arrange the placing of MiFID financial instruments and to purchase some or all the instruments that it may not succeed in placing with third parties. In other words, the placing element of A6 requires the same person to arrange the placing and provide a firm commitment that some or all of the instruments will be purchased.

Where a person distributes units in a UCITS fund to investors, in our view this does not amount to placing although it is likely to involve the reception and transmission of orders.

Q23. When might placing of financial instruments without a firm commitment basis arise (A7)?

Where the person arranging the placing does not undertake to purchase those MiFID financial instruments he fails to place with third parties.

Q24. What is a multilateral trading facility? (A8, article 4.1(15) and recital 6)

The concept of a multilateral trading facility (MTF) draws on standards, issued by CESR, on which the FSA's previous alternative trading system regime was based. It includes multilateral trading systems (for example, trading platforms) operated either by investment firms or by market operators which bring together multiple buyers and sellers of financial instruments.

As was the case with the alternative trading systems regime, in our view a multilateral trading facility does not include bilateral systems where an investment firm enters into every trade on own account (as opposed to acting as a riskless counterparty interposed between the buyer and the seller).

For there to be an MTF, the buying and selling of MiFID financial instruments in these systems must be governed by non-discretionary rules in a way that results in contracts. As the rules must be non-discretionary, once orders and quotes are received within the system an MTF operator must have no discretion in determining how they interact. The MTF operator instead must establish rules governing how the system operates and the characteristics of the quotes and orders (for example, their price and time of receipt in the system) that determine the resulting trades.

In our view, a firm can be an MTF operator whether or not it performs any other MiFID investment service or activity listed in A1 to A7.

Q25. What about ancillary services (Annex 1, section B)? Do we need to be authorised if we wish to provide these services?

Yes, but only when providing these services is a *regulated activity*, for example, if you provide custody services which fall within the *regulated activity* of *safeguarding and administering investments*. You are not an investment firm within the scope of MiFID, however, if you only perform ancillary services (regardless of whether these are *regulated activities* requiring *authorisation* under the Act).

Q26. We are an investment firm - can we apply for passporting rights that include ancillary services?

Yes, but only if:

- you carry on the ancillary services together with one or more investment services and activities; and
- where the ancillary service is also a *regulated activity*, you have a permission enabling you to carry on those activities.

You will not be able to apply for passporting rights in respect of ancillary services only. In our view, this does not restrict the ability of credit institutions to exercise passporting rights under the *BCD* which correspond to ancillary services under MiFID (for example, the activity of safekeeping and administration of securities in Annex 1 paragraph 12 of the *BCD*).

13.4 Financial Instruments

Q27. Where do we find a list of MiFID financial instruments?

In Section C of Annex 1 to MiFID. There are ten categories of financial instruments in Section C (C1 to C10). Transferable securities (C1) and money market instruments (C2) are defined in article 4. Further provisions relating to certain derivatives under C7 and C10 are contained in articles 38 and 39 of the *MiFID Regulation*.

Q28. What are transferable securities? (C1 and article 4.1(18))

Transferable securities refer to classes of securities negotiable on the capital markets but excluding instruments of payment. We consider that instruments are negotiable on the capital markets when they are capable of being traded on the capital markets.

Transferable securities include (to the extent they meet this test):

- shares in companies (whether listed or unlisted, admitted to trading or otherwise), comparable interests in partnerships and other entities and equivalent securities;
- bonds and other forms of securitised debt;
- depositary receipts in respect of the instruments above;
- securities giving the right to acquire or sell transferable securities (for example, warrants, options, futures and convertible bonds); and
- securitised cash-settled derivatives, including certain futures, options, swaps and other contracts for differences relating to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.

Examples of instruments which, in our view, do not amount to transferable securities include securities that are only capable of being sold to the issuer (as is the case with some industrial and provident society interests) and OTC derivatives concluded by a confirmation under an ISDA master agreement.

Q29. What are units in collective investment undertakings (C3)?

This category of financial instrument includes units in regulated and unregulated collective investment schemes. In our view, in accordance with article 1.2(a) and 2.1(o) of the

Prospectus Directive, shares in closed-ended corporate schemes, such as shares in investment trust companies, are also units in collective investment undertakings for this purpose (as well as being transferable securities).

Q30. Which types of financial derivative fall within MiFID scope (C4, C8 and C9)?

The scope of financial derivatives under MiFID is wider than under the ISD and includes the following:

- derivative instruments relating to securities, currencies, interest rates or yields, or other derivative instruments, financial indices or measures, that may be settled physically or in cash (C4);
- derivative instruments for the transfer of credit risk (C8); and
- financial contracts for differences (C9).

The scope of C4, C8 and C9 does not extend to spot transactions, transactions which are not derivatives (such as forwards entered into for commercial purposes) and sports spread bets. In our view, neither C4 nor C9 comprise forward foreign exchange instruments unless they are caught by the scope of the Regulated Activities Order (see *PERG* 2.6.22BG). A non-deliverable currency forward which is not a "future" for the purposes of the Regulated Activities Order because it is made for commercial purposes will likewise fall outside the scope of MiFID.

Q31. What are derivative instruments for the transfer of credit risk (C8)?

Derivative instruments that are designed for the purposes of transferring credit risk from one person to another. They include, for example, credit default products, synthetic collateralised debt obligations, total rate of return swaps, downgrade options and credit spread products.

Q32. Which types of commodity derivative fall within MiFID scope?

Broadly speaking, the following commodity derivatives fall within the scope of MiFID:

- a derivative relating to a commodity derivative, for example, an option on a commodity future (C4);
- cash-settled commodity derivatives (including physically settled derivatives that provide for settlement in cash at the option of one of the parties other than in the event of default or termination) (C5);

- physically settled commodity derivatives traded on a *regulated market* or MTF (C6); and
- other commodity derivatives capable of physical settlement and not for commercial purpose, that is standardised contracts subject to clearing house or margin arrangements so long as they fall into one of the following categories (C7):
    - instruments traded on a non-EEA trading facility that performs an analogous function to a *regulated market* or MTF;
    - instruments expressly stated to be traded on or subject to the rules of a *regulated market*, MTF or a non-EEA trading facility that performs an analogous function; or
    - back-to-back contracts with clients or counterparties equivalent to contracts traded on a *regulated market*, MTF or such a non-EEA trading facility.

Q33. What is a commodity for the purposes of MiFID?

"Commodity" means any goods of a fungible nature that is capable of being delivered, including metals and their ores and alloys, agricultural products and energy such as electricity (article 2.1 of the *MiFID Regulation*). The fact that energy products, such as gas or electricity, may be "delivered" by way of a notification to an energy network (such as notifications under the Network Code or the Balancing and Settlement Code) does not prevent them being "capable of being delivered" for these purposes. If a good is freely replaceable by another of a similar nature or kind for the purposes of the relevant contract (or is normally regarded as such in the market), the two goods will be fungible in nature for these purposes. Gold bars are a classic example of fungible goods. In our view, the concept of commodity does not include services or other items that are not goods, such as currencies or rights in real estate, or that are entirely intangible (recital 26 of the *MiFID Regulation*).

Q34. Are there any other derivatives subject to MiFID regulation?

There is a miscellaneous category of derivatives in C10, which is supplemented by articles 38 and 39 of the *MiFID Regulation*. These relate to:

- climatic variables;
- freight rates;
- inflation rates or other official economic statistics;
- telecommunications bandwidth;

- commodity storage capacity;
- transmission or transportation capacity relating to commodities, whether cable, pipeline or other means;
- an allowance, credit, permit, right or similar asset which is directly linked to the supply, distribution or consumption of energy derived from renewable resources;
- a geological, environment or other physical variable;
- any other asset or right of a fungible nature, other than a right to receive a service, that is capable of being transferred; or
- an index or measure related to the price or volume of transactions in any asset, right, service or obligation.

C10 derivatives must also meet at least one of the following criteria:

- the contract is settled in cash or may be settled in cash at the option of one or more of the parties, otherwise than by reason of default or other termination event; or
- the contract is traded in a *regulated market* or an MTF; or
- the contract is standardised, subject to clearing house or margin arrangements and falls into one or more of the categories described under the fourth bullet point in Q32 above.

13.5 Exemptions from MiFID

Q35. Where do we find a list of MiFID exemptions?

In articles 2 and 3 of MiFID.

Q36. We are an insurer. Does MiFID apply to us?

No. Insurers are exempt from MiFID (article 2.1(a)).

Q37. We are a non-financial services group company providing investment services to other companies in the same group. Are we exempt under the group exemption in article 2.1(b)?

Yes, if you provide these services exclusively for your parent company, your subsidiaries and those of your parent company. This means that providing investment services for the benefit of group companies must be the only investment service that you undertake. The exemption is narrower than the corresponding exclusion in article 69 of the Regulated Activities Order (groups and joint enterprises) insofar, for example, as it does not apply to investment services supplied to a joint venture participant (see *PERG* 2.9.10G).

Q38. We also buy and sell financial instruments for ourselves. Are we still able to use the group exemption?

Yes. The group exemption applies to investment services and not investment activities. So, as long as your own account dealing does not involve you providing an *investment service* (to which MiFID applies) to non-group entities, you can still rely on the group exemption in respect of the services you provide solely to other group companies.

So far as your own account dealing is concerned, you may be able to rely upon the exemption in article 2.1(i) (see Q44 and Q45) if you meet the relevant conditions. The ability to combine reliance on article 2.1(b) and article 2.1(i) could be relevant to companies performing group treasury functions.

Q39. We provide investment services as a complement to our main professional activity. Are we exempt?

Yes, you will be exempt under article 2.1(c) MiFID if you provide these services in an incidental manner in the course of your professional activity, and that activity is regulated by

legal or regulatory provisions or a code of ethics that do not exclude the provision of investment services. The meaning of 'incidental' is potentially subject to further Commission legislation pursuant to article 2.3 MiFID.

This exemption is relevant, for example, to firms belonging to *designated professional bodies*, such as accountants, actuaries and solicitors, to whom Part XX of the *Act* applies. It could also apply to *authorised professional firms* which provide investment services in an incidental manner in the course of their professional activity. In our view, the criteria set out in *PROF* 2.1.14G in relation to section 327(4) of the *Act* are also relevant to considering whether a firm can rely on the exemption in article 2.1(c) MiFID, as they were in relation to the corresponding ISD exemption.

If an *authorised professional firm* has the standard requirement on its permission that it "…must not carry on the specified regulated activities otherwise than in an incidental manner in the course of the provision by it of professional services (that is, services which do not consist of regulated activities)", our assumption is that it is exempt from MiFID if it complies with this requirement.

If you are an *authorised professional* firm not falling within article 2.1(c) MiFID, you may also wish to consider whether you are exempt or otherwise from MiFID requirements by virtue of the domestic implementation of the article 3 exemption (see Q48 and Q49).

The article 2.1(c) MiFID exemption may also apply to journalists, broadcasters and publishers (where they are subject to regulation or a code of ethics), although in most cases the FSA would not expect these persons to fall within the MiFID definition of investment firm (see Q7 and Q8).

Q40. We regularly buy and sell financial instruments ourselves but never as a service to third parties. Are there any exemptions which might apply to us?

Yes, you could fall within the article 2.1(d) MiFID exemption but not if you:

- are a market maker (please see Q41 below); or
- deal on own account outside a regulated market or an MTF on an organised, frequent and systematic basis by providing a system accessible to third parties in order to

engage in dealings with them. A system for these purposes might include a trading platform, website or other mechanism that functions on the basis of a set of rules.

You cannot rely, however, on the article 2.1(d) MiFID exemption if you provide any investment services or activities other than dealing on own account. If buying and selling MiFID financial instruments is not your main business, or, as the case may be, the main business of your group, you might though wish to consider further the exemption in article 2.1(i) MiFID (see Q44 and Q45).

Q41. What is a market maker?

A market maker is "a person who holds himself out on the financial markets on a continuous basis as being willing to deal on own account by buying and selling financial instruments against his proprietary capital at prices defined by him" (article 4.1(8) MiFID). This is likely to be the case if you are recognised or registered as a market maker on an investment exchange. However, in our view anyone who satisfies the definition will be a market maker for the purposes of MiFID, even if they are not under an obligation to make quotes, for example retail service providers who make a market in shares traded on the Stock Exchange Electronic Trading Service ('SETS') but without doing so as registered market makers under the rules of the London Stock Exchange.

Q42. Is there an exemption, as there was under the ISD, relating to employee share schemes and company pension schemes?

Yes, there is an exemption in article 2(1)(e) MiFID for persons providing investment services consisting exclusively in the administration of employee-participation schemes, for example employee share schemes and company pension schemes. In our view, whilst administration for these purposes could extend to services comprising reception and transmission or execution of orders on behalf of clients or placing, it would not include *personal recommendations* in relation to, or managing, the assets of employee share schemes or company pension schemes.

This exemption can also be combined with the "group exemption" in article 2.1(b) MiFID, by virtue of article 2.1(f) MiFID. In our view, it may also be combined with the exemption in article 2.1(i) MiFID if a firm is dealing on own account in financial instruments as an ancillary activity to its main business, or, as the case may be, the main business of its group.

Q43. Are we right in thinking that MiFID does not apply to collective investment undertakings and their operators?

Yes. Generally speaking, collective investment undertakings are specifically exempt, as are their depositaries and managers. So far as collective investment schemes are concerned, the "manager" corresponds, in essence, to the operator of a scheme and not to a person who is managing the assets of the scheme (unless that person is also the operator). In our view, the manager of a collective investment undertaking only benefits from the exemption in respect of any investment services or activities it may carry on in that capacity. To the extent that it also provides investment services or performs investment activities in a different capacity, for example, if it provides investment advice to, or manages the assets of, an individual third party, these services and activities fall outside the scope of the article 2.1(h) exemption.

In the case of *UCITS management companies*, some MiFID provisions will apply to those who provide portfolio management services, investment advice or safekeeping and administration services in relation to units to third parties, by virtue of article 5.4 of the *UCITS Directive* (see Q6).

Q44. Who can rely on the exemption in article 2.1(i)?

You may be able to rely on the exemption if:

- you deal on own account in MiFID financial instruments; or
- provide investment services in commodity derivatives or C10 derivative contracts to clients of your main business (or if you are part of a group, the group's main business); or
- both.

However, the exemption will only apply if what you do is ancillary to your main business and that main business is neither the provision of investment services nor banking services. If you are part of a group, what you do must be ancillary to the main business of your group whose main business is neither the provision of investment services nor banking services.

In our view, a firm which is part of a group whose main business is not investment or banking services and which provides, for example, as a stand-alone business, investment

services in commodity derivatives or C10 contracts for its own clients (who are not clients of the group's main business), is likely to fall outside the scope of the article 2.1(i) exemption.

When considering what is a firm's or group's 'main business', in our view various factors are likely to be relevant including turnover, profit, capital employed, numbers of employees and time spent by employees. These factors should then be considered in the round in deciding whether any one operation or business line amounts to a firm's or group's main business. In our view, a similar approach can be applied when determining a firm's 'main business' for the purposes of article 2.1(k) (see Q46).

Q45. What is an ancillary activity for these purposes?

The meaning of 'ancillary' is potentially subject to further European Commission legislation pursuant to article 2.3 MiFID. For an activity to be 'ancillary' for these purposes, in our view, it must at least be both directly related and subordinate to the main business of the group. Where, for example, a commodity producer buys or sells commodity derivatives for the purposes of limiting an identifiable risk of its main business, for instance in circumstances where the risk management exclusion in article 19 of the Regulated Activities Order would apply, in our view this would qualify as ancillary for the purposes of this exemption. On the other hand, where a commodity producer deals on own account for speculative purposes, it is unlikely that this would be ancillary to the main business in the case of article 2.1(i) MiFID. This activity may fall, however, within the article 2.1(k) MiFID exemption (see Q46).

Q46. Our main business is producing commodities and we buy and sell commodity derivatives. We are a member of a non-financial services group. Are we exempt from MiFID?

Yes. You will be exempt under article 2.1(k) MiFID because you are a person:

- whose main business consists of dealing on own account in commodities and/or commodity derivatives, and
- who is not part of a group whose main business is the provision of other investment services or banking services.

The question of what is your main business for the purposes of the first bullet point above is determined on an entity basis and not on a group basis (which is different from the approach

taken in article 2.1(i) MiFID). You should also note that the article 2.1(k) MiFID exemption refers to commodities and/or commodity derivatives but not C10 derivatives.

Recital 22 of the *MiFID Regulation* indicates that the exemptions in article 2.1(i) and (k) MiFID could be expected to exclude significant numbers of commercial producers and consumers of energy and other commodities, including energy suppliers and commodity merchants.

Q47. We traded on an investment exchange as a local firm and were exempt from the ISD. Are we exempt under MiFID?

Yes. If you fell within the exemption in article 2.2(j) ISD for local firms and continue to perform the same services and activities, you should generally fall within the exemption in article 2.1(l) MiFID. If you provide *personal recommendations* in relation to MiFID financial instruments, however, you will not be able to rely upon the exemption in article 2.1(l) MiFID.

Q48. Article 3 is an optional exemption. Will the exemption apply to UK firms?

Yes, the optional exemption has been exercised by The Treasury.

Q49. Which firms might fall within this exemption?

The exemption applies to persons who meet all the following conditions:

- they do not hold clients' funds or securities;
- they do not provide any investment service other than reception and transmission of orders or investment advice, or both, in relation to transferable securities and units in collective investment undertakings;
- they transmit orders only to one or more of the following:
    - other MiFID investment firms;
    - credit institutions authorised under the BCD;
    - branches of third country investment firms or credit institutions complying with rules considered by the FSA to be at least as stringent as those laid down in MiFID, the BCD or the CAD;
    - collective investment undertakings or their managers authorised under the law of an EEA State to market units to the public;

- EU incorporated investment companies the securities of which are listed or dealt in on a *regulated market*, for example investment trust companies.

If you are a UK firm that meets these qualifying conditions, you will be exempt from regulations made by the European Commission under MiFID.

Where you provide *personal recommendations* or receive and transmit orders in relation to derivatives which are MiFID financial instruments but not transferable securities, you will fall outside the scope of this exemption. In our view, this would be the case, for example, if you provided either or both of these investment services in relation to OTC derivatives concluded by a confirmation under an ISDA master agreement (see PERG 13 Annex 2 Table 2).

Q50. We are (or previously were) an IFA and have a permission which covers (i) arranging (bringing about) deals in investments; (ii) making arrangements with a view to transactions; and (iii) advising on investments, in each case in relation to securities but not derivatives. We are not permitted to hold client money or investments and do not have dealing or managing permissions in relation to MiFID financial instruments. Are we exempt?

The FSA expects so, assuming you do not:

- carry on activities outside your permission; or
- transmit orders to persons other than those listed in Q49 (for example, you will fall outside the exemption if you transmit orders directly to collective investment schemes whose units cannot be marketed to the public in any EEA State either because they are unregulated schemes or non-EEA authorised collective investment schemes); or
- place MiFID financial instruments without a firm commitment basis (see Q22 and Q23).

We would generally not expect IFAs to be placing MiFID financial instruments without a firm commitment basis as we associate placing of financial instruments with situations where a company or other business vehicle wishes to raise capital for commercial purposes, and in particular with primary market activity.

Q51. What happens if we breach any of the qualifying conditions (see Q49)? Do we then lose the exemption?

You are required to notify us of a breach (see SUP 15.3.11R). We will then consider whether you should continue to benefit from the exemption and what, if any, supervisory or occasionally enforcement action is appropriate in the circumstances.

Q52. If we fall within the exemption does this prevent us from acquiring passporting rights under MiFID?

No. Firms which would otherwise be exempt can apply to opt into MiFID regulation with a view to acquiring passport rights (although they would then become subject to the requirements of MiFID, including certain enhanced prudential requirements – see Q58 and Q59).

Q53. What is the practical effect of exercising the optional exemption for those firms falling within its scope?

You are not a firm to which MiFID applies and so are not a *MiFID investment firm* for the purposes of the FSA Handbook. As such you are not subject to the requirements of the recast CAD as transposed in the FSA Handbook and cannot exercise passporting rights.

13.6 The recast Capital Adequacy Directive

Q54. What is the purpose of this section?

This section is designed to help UK investment firms consider:

- whether the recast CAD, as implemented in the UK, applies to them;
- if so, which category of firm they are for the purposes of the FSA's base capital resources requirements made under the recast CAD, for example whether they are a *BIPRU 50K firm*, a *BIPRU 125K firm*, a *BIPRU 730K firm*, a *UCITS investment firm*, an *exempt CAD firm* or a firm falling within the transitional regime for certain commodity brokers and dealers; and
- how the recast CAD otherwise impacts on their business, by explaining when a firm will be a *limited licence firm*, a *limited activity firm* or a *full scope BIPRU investment firm*.

This section is intended to provide a general summary of these issues and not a detailed or exhaustive explanation of the recast CAD as implemented in the UK.

Q55. Are we subject to the recast CAD?

Only investment firms subject to the requirements of MiFID are subject to the requirements of the recast CAD. This includes *UCITS investment firms* (see Q6 and Q63).

Despite being subject to the requirements of MiFID, broadly speaking, if you are one of the following investment firms our implementation of the recast CAD will only apply to you in a limited way:

- a firm whose main business consists exclusively of providing *investment services or activities* in relation to commodity derivatives or C10 derivatives, or both, and to whom the ISD would not have applied. If you fall into this category, you will fall within a transitional regime under which you will not be subject to the capital requirements of the recast CAD but will be subject to other requirements (see Q57); or
- a firm that is only authorised to provide investment advice or receive and transmit orders, or both, without holding client money or securities. If you fall into this

category, you will be an *exempt CAD firm* and only subject to base capital requirements under the recast CAD (see Q58 and Q59 below).

If you are an investment firm to which an exemption in either article 2 or article 3 MiFID applies (see PERG 13.5 and PERG 13 Annex 1 flow chart 2), you are not subject to the recast CAD. However, if you potentially fall within the article 3 exemption, but decide to opt into MiFID regulation, for instance to acquire passporting rights (see Q52), you are subject to the recast CAD. If you do so, you are an *exempt CAD firm* (see Q58 and Q59).

There is also a special exemption under the recast CAD for locals that do not fall within the exemption for local firms under MiFID (see Q47). However, we do not think that UK regulated firms that were subject to the regulatory regime for locals prior to MiFID implementation are likely to fall within the exemption under the recast CAD. This is because they are likely to fall within article 2.1(l) MiFID.

Q56. We are an investment firm to which MiFID applies and do not fall into one of the limited categories described above. How does the recast CAD apply to us?

You are a *CAD investment firm*. Broadly speaking, you should go through an initial two-stage process in considering how the recast CAD will apply to you:

- consider what kind of base capital requirements apply to you; and
- consider whether you are a *limited licence firm*, a *limited activity firm* or a *full scope BIPRU investment firm* to determine how other capital requirements of the recast CAD apply to you.

You are either a *BIPRU 50K firm* (subject to a base capital requirement of euro 50,000) (see Q60), a *BIPRU 125K firm* (subject to a base capital requirement of euro 125,000) (see Q61), a *BIPRU 730K firm* (subject to a base capital requirement of euro 730,000) (see Q62) or a *UCITS investment firm* (see Q63). Your base capital requirement depends essentially on the scope of your *permission* and any limitations or requirements placed upon it.

If you are a *CAD investment firm*, in essence the scope of your *permission* and any limitations or requirements placed upon it also dictate whether you are a *limited licence firm*, a *limited activity firm* or a *full scope BIPRU investment firm*. Broadly speaking, the benefit of being a

limited licence firm or a *limited activity firm* (see Q64 and Q65) is that you are exempt from minimum own funds requirements to hold capital to cover operational risk, although you are subject to the requirements to hold own funds calculated by reference to credit risk, market risk and fixed overheads (see *GENPRU* 2.1.45R). If you are a *full scope BIPRU investment firm*, you are subject to the full range of recast CAD risk requirements (see Q66). See, generally, *GENPRU* 2.1.45R in relation to the calculation of capital resources requirements for *limited licence firms, limited activity firms* and *full scope BIPRU investment firms*.

The question of whether you are a *limited licence firm* or a *limited activity firm* may also be relevant to capital treatment at a group level. This is outside the scope of this guidance which focuses only on the application of the recast CAD at the level of the individual firm, although you may find the decision tree at BIPRU 8 Annex 5R helpful in considering these issues.

Q57. How do we know if we are a firm to which the transitional regime for certain commodity brokers and dealers applies?

You are a firm to which the transitional regime applies if:

- you are a firm to which the ISD did not or would not have applied on 31 December 2006; and
- your main business consists exclusively of the provision of investment services or activities in relation to financial instruments set out in C5, 6, 7, 9 and 10 of Annex 1 of MiFID. See *BIPRU* TP 15.

This exemption is only relevant if you are a firm to which MiFID applies, that is, you do not fall within the exemptions in articles 2 or 3 of MiFID (see Q55). Although you are exempt from the capital requirements of the recast CAD, you are subject to risk management and other systems and control requirements in the form of *SYSC* (see *BIPRU* TP 15.11G). You may also be subject to the requirements of chapter 3 of *IPRU(INV)*.

In our view, your main business for the purposes of this exemption is the main business to which MiFID applies.

Q58. How do we know whether we are an exempt CAD firm and what does this mean in practice?

This category may be relevant to you if you have permission to *advise on investments* or *arrange deals in investments* in relation to MiFID financial instruments but fall outside the article 3 MiFID exemption (for example, because you choose to opt out of the exemption or because you transmit orders to persons not listed in the exemption or provide services in relation to derivatives that are not transferable securities). You can be an *exempt CAD firm* if you:

- are not authorised to hold client money in relation to MiFID business;
- do not have a *safeguarding and administering investments (without arranging)* permission in relation to MiFID financial instruments; and
- have a requirement on your permission so that the only MiFID investment services and activities you can perform are reception and transmission of orders or investment advice or both.

Where you hold client money for purposes unconnected with providing investment advice or receiving and transmitting orders in relation to MiFID financial instruments, in our view you can still be an *exempt CAD firm*. This might include, for instance, when you hold money or securities for clients to whom you only provide services that do not constitute *investment services* and therefore fall outside the scope of MiFID.

The conditions relating to the article 3 MiFID exemption look similar to those for an *exempt CAD firm*. There are important differences, however, between the two:

- the article 3 MiFID exemption (see Q49) extends only to services provided in relation to transferable securities and units in collective investment undertakings, whereas no such restriction applies to *exempt CAD firms*; and
- the article 3 MiFID exemption requires orders to be transmitted to certain persons only (see Q49 and Q50), whereas no such restriction arises in the case of *exempt CAD firms*.

If you are an *exempt CAD firm*, you are subject to base capital requirements which comprise the following broad options:

- base capital of euro 50,000; or
- professional indemnity insurance of euro 1,000,000 for any one claim and euro 1,500,000 in aggregate; or

- a combination of base capital and professional indemnity insurance resulting in an equivalent level of coverage to the options above.

For the rules transposing these requirements and supporting guidance, see the Interim Prudential Sourcebook for Investment Businesses (Exempt CAD Firms) Instrument 2007 and in particular sections 13.1 and 13.1A and chapter 9. You will be subject to the relevant ongoing requirements in the Interim Prudential Sourcebook for Investment Businesses relating to securities and futures firms and personal investment firms, as appropriate (see *IPRU(INV)* 13.1A.6R and *IPRU(INV)* 9.2.8R).

Q59. If we are subject to the Insurance Mediation Directive, does this make any difference to the requirements which apply?

Yes. If the only *investment services* that you are authorised to provide are investment advice or receiving and transmitting orders or both, without holding client money or securities, you can still be an *exempt CAD firm*. However, you are subject to different base capital requirements. Broadly speaking, article 8 recast CAD requires you to have professional indemnity insurance of euro 1,000,000 for any one claim and euro 1,500,000 in aggregate (this is the *IMD* requirement), plus coverage in one of the following forms:

- base capital of euro 25,000; or
- professional indemnity insurance of euro 500,000 for any one claim and euro 750,000 in aggregate; or
- a combination of base capital and professional indemnity insurance resulting in an equivalent level of coverage to the options above.

For the rules transposing these requirements and supporting guidance, see the final paragraph of the answer to Q58.

As mentioned in Q58, when you hold client money or securities for purposes unconnected with providing investment advice or receiving and transmitting orders in relation to MiFID financial instruments, in our view you can still be an *exempt CAD firm*. This might include, for instance, when you hold client money for those to whom you provide insurance mediation services.

You should also bear in mind that if you are a firm to whom article 2 or article 3 MiFID applies (see *PERG* 13.5), you are not subject to the recast CAD.

Q60. Are we a BIPRU 50K firm?

This category may be relevant to you if you are not an *exempt CAD firm* and have one or more of the following permissions in relation to MiFID financial instruments:

- *arranging (bringing about) deals in investments*;
- *dealing in investments as agent*; or
- *managing investments*,

provided that you are not authorised to:

- hold client money in relation to MiFID business or *safeguard and administer (without arranging)* MiFID financial investments; or
- deal on own account in, or underwrite on a firm commitment basis, issues of MiFID financial instruments (if you have a *dealing in investments as principal* permission in relation to MiFID financial instruments, you need a limitation or requirement on your permission to this effect).

Q61. Are we a BIPRU 125K firm?

This category may be relevant to you if you would have been a *BIPRU 50K firm* but for the fact that you are entitled to hold client money in relation to MiFID business or hold MiFID financial instruments.

You may also be a *BIPRU 125K firm* if you meet the conditions of article 5.2 recast CAD. Broadly speaking, this applies to investment firms which execute investors' orders and hold financial instruments for their own account provided that:

- such positions arise only as a result of the firm's failure to match investors' orders precisely;
- the total market value of all such positions is subject to a ceiling of 15% of the firm's initial capital;
- the firm meets the requirements laid down in articles 18, 20 and 28 recast CAD (including own funds requirements in respect of position risk, settlement and counterparty credit risk and large exposures); and

- such positions are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question.

If you meet the conditions of article 5.2 recast CAD and are not authorised to hold client money in relation to MiFID business or *safeguard and administer (without arranging)* MiFID financial instruments, you will be a *BIPRU 50K firm*.

Q62. Are we a BIPRU 730K firm?

If you are a *CAD investment firm* and you are neither a *BIPRU 50K firm* nor a *BIPRU 125K firm* nor a *UCITS investment firm* (see Q63), you will be a *BIPRU 730K firm*.

Q63. We are a UCITS investment firm. How will the recast CAD apply to us?

UCITS investment firms (*UCITS management companies* that are authorised to perform the additional services of portfolio management, investment advice and safeguarding and administration of units) are subject to the recast CAD in parallel with the capital requirements in the *UCITS Directive*.

If you are a *UCITS investment firm*, your base capital requirement is contained in *GENPRU* 2.1.48R (which refers to *UPRU* 2.1.2R(1)) and in summary is:

- a minimum base capital requirement of euro 125,000; and
- an additional amount of own funds equal to 0.02% of the amount by which the value of the portfolios under management exceeds euro 250,000,000 (subject to an overall maximum base capital requirement of euro 10,000,000).

In our view, a *UCITS investment firm* should be a *limited licence firm*, as the *UCITS Directive* prevents it from dealing on own account outside its scheme management activities. As a result, where a *UCITS investment firm* has a *dealing in investments as principal* permission, this should be limited to box management activities where MiFID financial instruments are concerned. In our view, a *UCITS investment firm* which has this limitation and complies with it will not be dealing on own account for the purposes of the MiFID and the recast CAD.

Q64. Are we a limited licence firm?

A *limited licence firm* is one that is not authorised to:

- deal on own account (see Q16); and
- underwrite and/or place financial instruments on a firm commitment basis (see Q22).

You can be a *limited licence firm* if you are either:

- a *BIPRU 50K firm* (see Q60); or
- a *BIPRU 125K firm* (see Q61).

Generally, you cannot be a *limited licence firm* if you are a *BIPRU 730K firm*. However, you may be a *limited licence firm* if you operate a multilateral trading facility (and therefore are a *BIPRU 730K firm*) and do not have a *dealing in investments as principal* permission enabling you to deal on own account or to underwrite or place financial instruments on a firm commitment basis.

For calculation of the variable capital requirement for a *BIPRU limited licence firm* (including a *UCITS investment firm*), see *GENPRU* 2.1.45R.

Q65. Are we a limited activity firm?

A *limited activity firm* is a *BIPRU 730K firm* that deals on own account only for the purpose of:

- fulfilling or executing a client order; or
- gaining entrance to a clearing and settlement system or a recognised exchange when acting in an agency capacity or executing a client order.

If you wish to be a *limited activity firm*, you should apply for a limitation on your *dealing in investments as principal* permission reflecting these conditions.

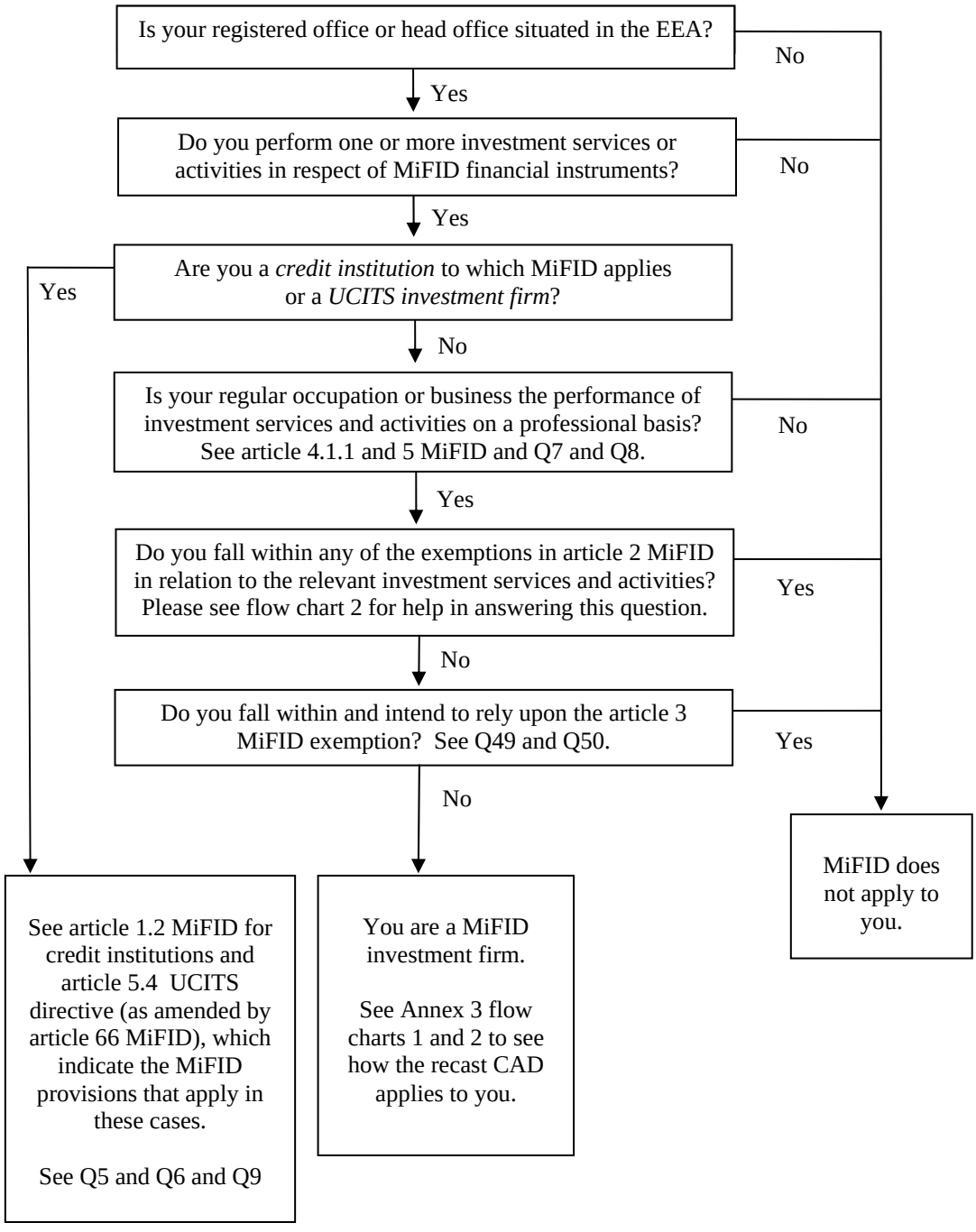
There is also a category for certain firms which, among other things, do not hold client money or securities and have no external customers. We do not think that any UK regulated firms are likely to fall within this third category of *limited activity firm*.

Q66. What is the effect of being a CAD investment firm which is neither a limited licence firm nor a limited activity firm?

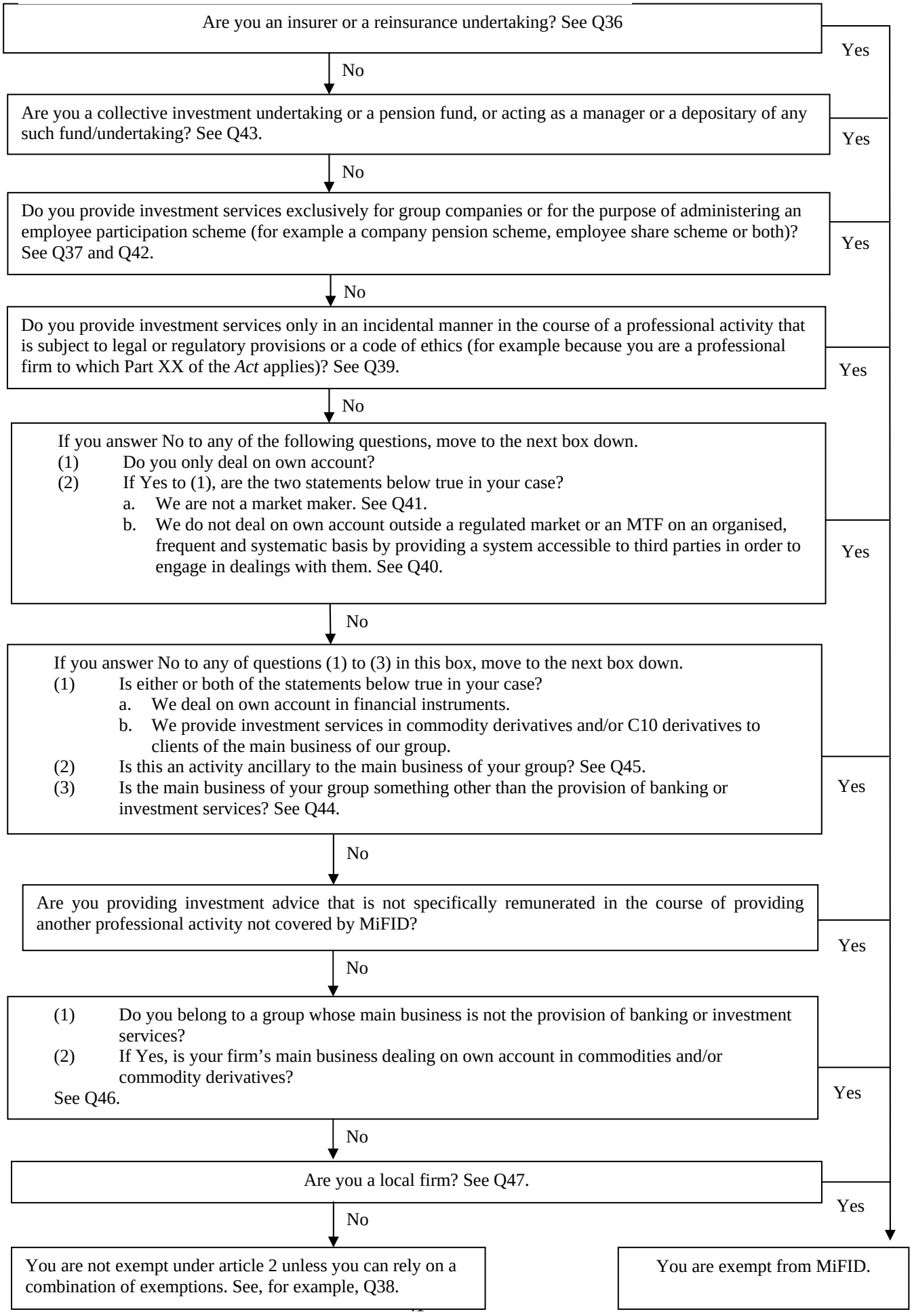
You will be a *full scope BIPRU investment firm*, subject to the full range of recast CAD risk requirements.

ANNEX 1

Flow chart 1- Does MiFID apply to us?



Flow chart 2- Am I exempt under article 2 MiFID?



ANNEX 2

Table 1 - MiFID Investment services and activities and the Part IV permission regime

MiFID Investment Services and Activities	**Part IV permission**	**Comments**
A1- Reception and transmission of orders in relation to one or more financial instruments	Arranging (bringing about) deals in investments (article 25(1) *RAO*).	This was an ISD service. Generally speaking, only firms with permission to carry on the activity of arranging (bringing about) deals in investments in relation to securities and contractually based investments which are financial instruments can provide the service of reception and transmission. This is because a service must bring about the transaction if it is to amount to reception and transmission of orders. The activity of arranging (bringing about) deals in investments is wider than A1, so a firm carrying on this regulated activity will not always be receiving and transmitting orders. See Q13 and Q14 for further guidance.
A2- Execution of orders on behalf of clients	Dealing in investments as agent (article 21 *RAO*) Dealing in investments as principal (article 14 *RAO*)	This was an ISD service. Usually, where a firm executes orders on behalf of clients it will need permission to carry on the activity of dealing in investments as agent. Where a firm executes client orders on a true back-to-back basis or by dealing on own account, it also needs permission to carry on the activity of dealing in investments as principal. See Q15 for further guidance.
A3- Dealing on own account	Dealing in investments as principal (article 14 *RAO*)	Dealing on own account falls within the ISD, but only where a service is provided. Under MiFID, dealing on own account is caught even if no service is provided. Where a firm is dealing on own account, it needs permission to carry on the activity of dealing in investments as principal. See Q16 for further guidance.

A4- Portfolio management	Managing investments (article 37 *RAO*) Dealing in investments as principal (article 14 RAO) Dealing in investments as agent (article 21 RAO) Arranging (bringing about) deals in investments (article 25(1) RAO) Making arrangement with a view to transactions in investments (article 25(2))	This was an ISD service. A firm performing the portfolio management service needs a permission to carry on the activity of managing investments. Firms may also need permission to perform other regulated activities to enable them to give effect to decisions they make as part of their portfolio management (see adjacent column). See Q6, Q17 and Q43 for further guidance.
A5- Investment advice	Advising on investments (article 53 *RAO*)	This was an ISD non-core service. A firm providing investment advice will need permission to carry on the activity of advising on investments. See Q18 and Q19 for further guidance.
A6- Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis	Dealing in investments as principal (article 14 *RAO*) Dealing in investments as agent (article 21 *RAO*)	This corresponds broadly to the service of underwriting and/or placing described in Section A4 of the Annex to ISD. Where a firm underwrites an issue of financial instruments and holds them on its books before they are sold or offered to third parties, it needs permission to carry on the activity of dealing in investments as principal. Where an underwriting firm sells the relevant instruments as agent for the issuer and then purchases any remaining instruments as principal, it needs permission to carry on the activity of dealing in investments as agent in relation to its selling activity and of dealing in investments as principal in relation to its purchase of the remaining instruments.

		See Q22 for further guidance.
A7- Placing of financial instruments without a firm commitment basis	Dealing in investments as agent (article 21 *RAO*) Arranging (bringing about) deals in investments (article 25(1) *RAO*)	This corresponds in part to the service in Section A4 of the Annex to ISD outlined in the commentary to A6. Where a firm arranges the placement of financial instruments with another entity, it needs permission to carry on the activity of arranging (bringing about) deals in investments. Where a firm sells the relevant instruments on behalf of the issuer, it also needs permission to carry on the activity of dealing in investments as agent. See Q22 for further guidance.
A8- Operation of Multilateral Trading Facilities	Operating a multilateral trading facility (article 25D *RAO*)	This service replaces the ATS operators regime. Firms performing this service will need permission to carry on the regulated activity of operating a multilateral trading facility. Broadly speaking, any authorised person who operated an alternative trading system prior to 1 November 2007 was automatically granted permission to operate a multilateral trading facility, unless it notified the FSA to the contrary by 1 October 2007. Firms will not require permission to carry on any other regulated activities if all they do is operate a multilateral trading facility. If they carry on additional regulated activities, they should ensure that their permission properly reflects this. See Q24 for further guidance.

Table 2: MiFID financial instruments and the Part IV permission regime

MiFID financial instrument	Part IV permission category	Commentary
C1- Transferable securities	share (article 76) debenture (article 77) government and public security (article 78) warrant (article 79) certificate representing certain securities (article 80) unit (article 81) option (excluding a commodity option and option on a commodity future) future (excluding a commodity future and a rolling spot forex contract) contract for differences (excluding a spread bet and a rolling spot forex contract) spread bet	Transferable securities are securities negotiable on the capital market excluding instruments of payment and include: (a) shares in companies (b) bonds; (c) depositary receipts; (d) warrants; and (e) miscellaneous securitised derivatives. Transferable securities comprise various categories of derivatives in the permission regime: for example, options (excluding commodity options and options on commodity futures); futures (excluding commodity futures and rolling spot forex contracts); contracts for differences (excluding spread bets and rolling spot forex contracts). The permission investment categories above, however, are wider than the MiFID definition of transferable securities, as they comprise both securitised and non-securitised instruments. Firms with permissions containing these investment categories will fall outside the article 3 MiFID exemption as transposed in domestic legislation, where they provide investment services in relation to financial instruments which are non-securitised investments (for example, OTC derivatives concluded by a confirmation under an ISDA master

		agreement). For further guidance on the article 3 exemption see Q49; for further guidance on transferable securities see Q28.
C2- Money market instruments	debenture (article 77) government and public security (article 78) certificate representing certain securities (article 80)	The definition in article 4.1(19) MiFID refers to classes of instruments normally dealt in on the money markets.
C3- Units in a collective investment undertaking	unit (article 81) shares (article 76)	C3 includes units in regulated and unregulated collective investment schemes. This category also includes closed-ended corporate schemes, such as investment trust companies (hence the reference to shares in the adjacent column). For further guidance, see Q29.
C4- Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash	option (excluding a commodity option and an option on a commodity future) commodity option and option on a commodity future future (excluding a commodity future and a rolling spot forex contract) rolling spot forex contract contract for differences (excluding a spread bet and a rolling spot forex contract) spread bet	C4 includes the financial instruments in sections B3-6 of the Annex to the ISD and in our view derivatives relating to commodity derivatives, for example options on commodity futures. For further guidance, see Q30 and Q32. Note that for the purposes of the permission regime, commodity options and options on commodity futures are treated as a single permission category. (see *PERG* 2 Annex 2 Table 2).
C5- Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash or may be settled in	commodity option and option on a commodity future commodity future	C5 instruments are generally contracts for differences. Where a C5 instrument provides for the possibility of physical settlement, it may also be either

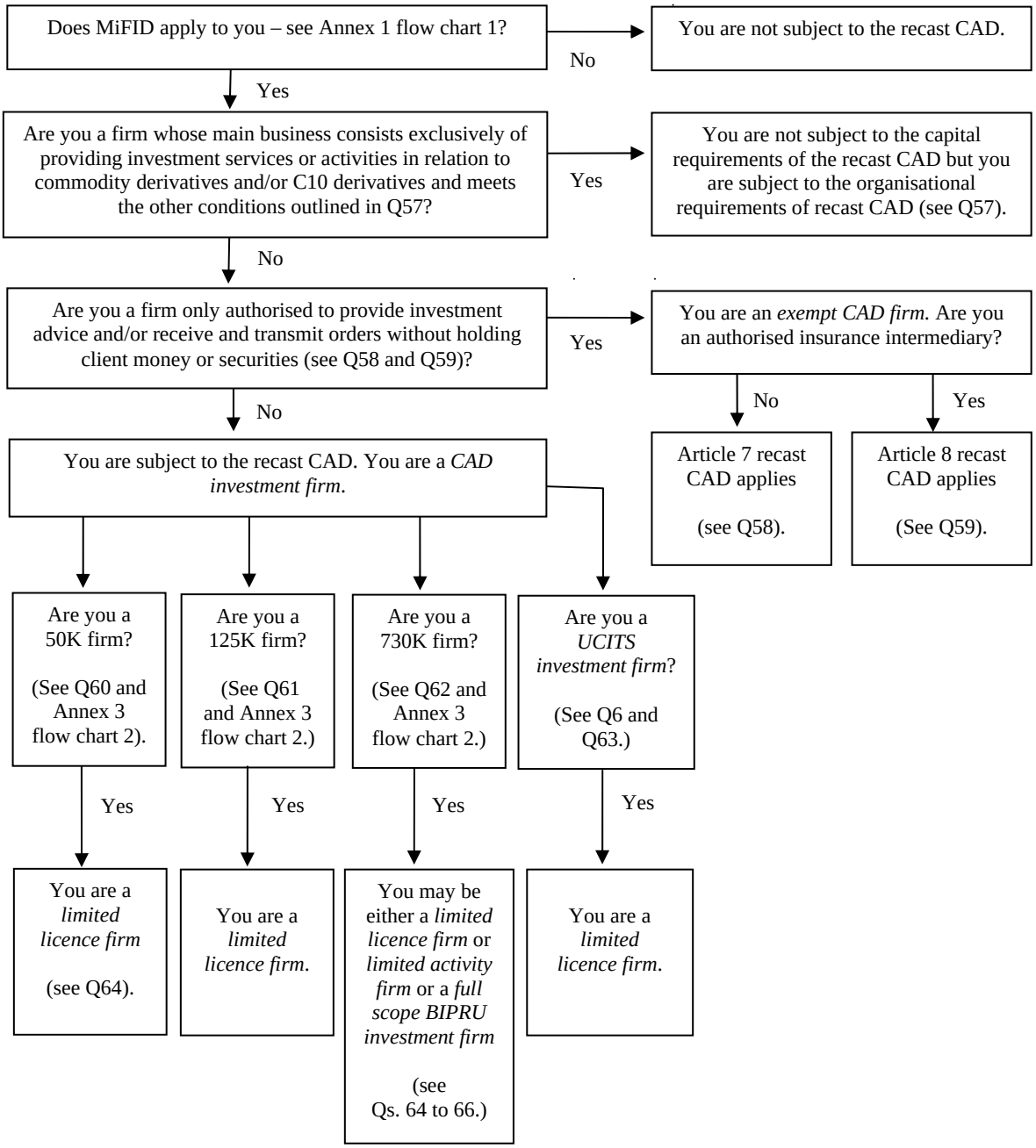
cash at the option of one of the parties (otherwise than by reason of a default or other termination event)	contract for differences (excluding a spread bet and rolling spot forex contract)	a commodity future or commodity option, depending on its structure. For further guidance see Q32 and Q33.
C6- Options, futures, swaps, and any other derivative contracts relating to commodities that can be physically settled provided that they are traded on a regulated market and/or an MTF	commodity option and option on a commodity future commodity future contract for differences (excluding spread bet and rolling spot forex contract)	C6 instruments will generally be either commodity futures or commodity options, depending on their structure. Those instruments with a cash settlement option may also be contracts for differences. For further guidance see Q32 and Q33.
C7- Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C.6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls	commodity option and option on a commodity future commodity future contract for differences (excluding spread bet and rolling spot forex contract)	C7 is supplemented by Level 2 measures (see article 38 of the *MiFID Regulation*). For further guidance see Q32 and Q33.
C8- Derivative instruments for the transfer of credit risk	option (excluding a commodity option and an option on a commodity future) contract for differences (excluding spread bet and rolling spot forex contract) spread bet rolling spot forex contract	C8 derivatives are financial instruments designed to transfer credit risk, often referred to as credit derivatives. For further guidance see Q31.
C9- Financial contracts for differences	contract for differences (excluding spread bet and rolling spot forex contract) spread bet	In our view, C9 derivatives could include those contracts for differences with a financial underlying, for example the

	rolling spot forex contract	FTSE index.
C10- Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognised clearing houses or are subject to regular margin calls.	option (excluding commodity option and option on a commodity future) future (excluding a commodity future and a rolling spot forex contract) contract for differences (excluding spread bet and rolling spot forex contract) spread bet	C10 is supplemented by Level 2 measures (see articles 38 and 39 of the *MiFID Regulation*) and comprises miscellaneous derivatives. For further guidance see Q34.

Note

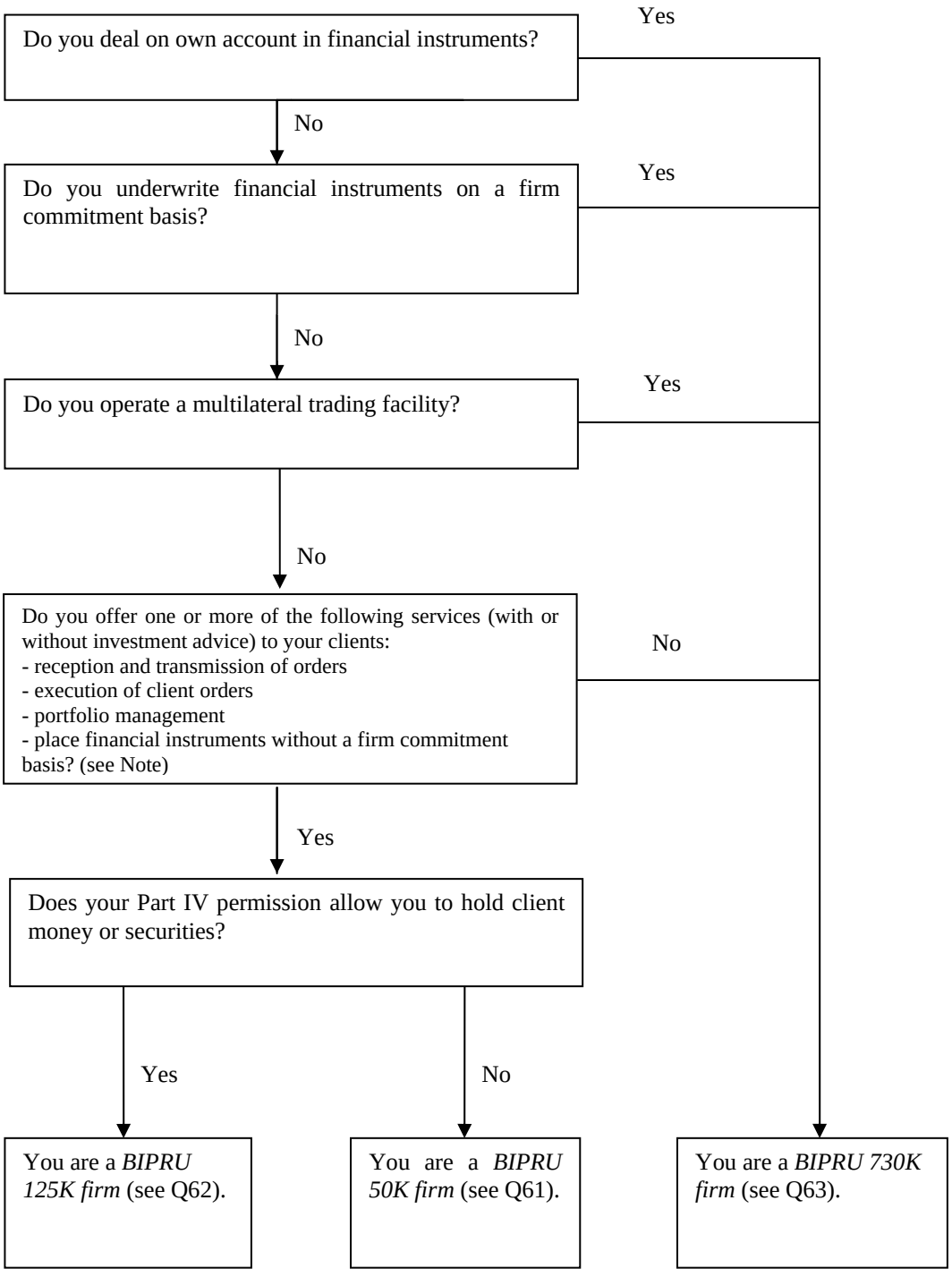
In our view, the categories of financial instrument in C1 to C10 are not mutually exclusive, so a financial instrument may fall within more than one category. For example, an interest in an investment trust company falls within C1 and C3.

ANNEX 3
Flow chart 1- Are you subject to the recast CAD?



Flow chart 2 – *CAD investment firms* (excluding *UCITS investment firms*)

Are we a *BIPRU 50K firm*, a *BIPRU 125K firm* or a *BIPRU 730K firm*?



Note

It is possible, in principle, that a *CAD investment firm* may only provide the *investment service* of investment advice and hold client funds or securities, in which case the starting point is generally that it is a *BIPRU 730K firm*. In practice, if such a firm wishes to benefit from a lower capital treatment (for example euro 125,000), it may wish to add an *arranging (bringing about) deals in investments* element to its permission to enable it to receive and transmit orders in relation to MiFID instruments.

Annex 4 – Principal Statutory Instruments relating to MiFID scope issues

1. The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment No. 3) Order 2006 [SI 2006 No. 3384]

2. The Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2007 [SI 2007 No 126]

3. The Financial Services and Markets Act 2000 (Markets in Financial Instruments) (Modification of Powers) Regulations 2006 [SI 2006 No 2975]

4. The Financial Services and Markets Act 2000 (Appointed Representatives) (Amendment) Regulations 2006 [SI 2006 No 3414]

5. The Financial Services and Markets Act 2000 (Exemption) (Amendment) Order 2007 [SI 2007 No 125]