Public Consultation on national discretions in the Markets in Financial Instruments Directive ("MiFID 2")

Feedback Statement

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Introduction

The Department of Finance held a public consultation on the national discretions contained in the Markets in Financial Instruments Directive ("MiFID 2") and elements of the Insurance Distribution Directive ("IDD") from 7 July until 21 September 2016 (see here). This feedback statement should be read in conjunction with the public consultation document.

Fourteen submissions were received, from investment firms, banks, law firms, professional associations and also from the public. The Minister would like to thank all those who submitted responses to the consultation for their valuable contribution to the transposition process.

The purpose of this feedback statement is to bring greater transparency and clarity to the transposition process by way of:

- publishing the responses to the public consultation;
- providing a summary of the responses to each question in the public consultation; and
- setting out the decisions which the Minister has taken in relation to the national discretions.

The Minister is no longer inviting comments in relation to the decisions outlined in this feedback statement.

Transposition Delay

The transposition date of the 3 July for the Directive has not been met due to a number of circumstances. The Department is continuing to work on the transposing regulations, which we expect to complete in the coming weeks. In the interim we hope that anyone who may be affected by the decisions on the national discretions will find this feedback statement to be helpful.

Summary of Responses & Minister's Decisions

This section gives a brief summary of the responses to the questions in the Public Consultation and outlines the Ministers decisions. The responses in full are published here.

Optional Exemptions

Question 1a – Whether to exempt persons from the MiFID 2 regulations meeting the conditions set out in Article 3 (1) (a) – (c), insofar as permitted by Article 3(2)

This concerns the national discretion in *Article 3(1) (a)-(c) of* MiFID 2. Nearly all those who responded were in favour of exercising this discretion on the basis of a continuation of the current regime. A respondent who is against exercising this discretion cited level playing field considerations and the undesirability of different treatment applied to consumers dependent on whether they go to a MiFID firm or non-MiFID firm.

The Minister has decided to exempt firms qualifying under Article 3 (1) paragraphs (a), (b) and (c), though this exemption can only be on the basis of meeting the legal requirements in Article 3(2). The Minister acknowledges the argument that level playing field rules should apply but considers that to fully bring Article 3 (1) (a)-(c) firms into the MiFID framework would represent a disproportionate response having regard to the fact that the conditions to qualify for the partial exemption addresses the risks arising. The Minister also understands that very many such firms are micro enterprises providing services at a local level.

Question 1b – To identify the provisions listed in Article 3(2) which have no corresponding domestic rules/requirements which are at least analogous

One respondent set out reasons as to why the current national regime should be considered broadly analogous across the Article 3(2) list, also citing proportionality grounds which should be taken into account. One respondent suggested that the broadest permissible interpretation of "at least analogous" is taken.

In accordance with our legal advice, in order to identify which provisions listed in the Article 3(2) list have no corresponding domestic rules which are at least analogous ('gap list'), it is necessary to:

- include the MiFID level 2 rules[1] in our analysis, as Article 3(2) requires this and in any event the meaning of a principles based rule in the level 1 MiFID text can only be ascertained by examining the corresponding level 2 rules; and
- exclude any domestic requirements which do not have a statutory footing, for example those in Central Bank guidelines, authorisation forms or other communications.

[1] Level 2 rules are delegated or implementing acts adopted by the Commission in accordance with empowerments set out in the MiFID (level 1) text. They are legally binding and their purpose is to support the uniform implementation of the rules across the EU. See Official Journal of the EU for the complete list of MiFID Delegated Acts, Regulatory Technical Standards and Implementing Technical Standards.

Assessment of Article 3(2) requirements
The Department, with input from the Central Bank, addressed this issue in the public consultation, indicating that at that point several gaps were identified. The final package of relevant MiFID level 2 rules was only published by the European Commission in the Official Journal of the EU on 31 March 2017.

Consumer Protection requirements
Further analysis has identified a larger 'gap list', which mostly relate to client disclosures on commissions, charges and costs as well as certain conflict of interest requirements. This reflects a more general theme in MiFID 2 to strengthen investor protection.

In order to continue to exempt firms qualifying under Article 3(1) (a)-(c) from the onerous MiFID rulebook it is necessary to amend domestic rulebooks to incorporate the additional provisions listed below. The Central Bank will amend its Consumer Protection Code to reflect the changes required in order to satisfy the requirements of Article 3(2) MiFID.

Firms qualifying under Article 3(1) (a)-(c) (when providing the limited MiFID services which they are permitted to provide and/or advising on or selling investment products as defined in the Central Bank's Consumer Protection Code 2012 (as amended)) will be required to:

- obtain specified information from product producers and to understand the characteristics and identified target market of each product they are selling;
- either ensure the recording of telephone conversations leading to or intending to lead to a transaction or, in the alternative, follow up such telephone conversations with a written communication to the client confirming the relevant details of the conversation (pertaining to the order) and providing the client with an opportunity to amend or withdraw an order;
- provide clients with disclosures on conflicts of interest which include a specific description of the conflicts of interest, an explanation of the risks that arise to clients and the steps undertaken to mitigate these risks;
- advise clients whether they will provide them with a periodic assessment of the suitability of the investment product recommended to them and if they are providing this enhanced 'after-sale' service to provide certain other details as to the nature of the service;
- aggregate the costs and charges in disclosures to clients to allow the client to understand the overall cost and provide their clients with illustrative examples to enable them to better understand the cumulative effect of these on investor returns;
- where actual costs are not available, to make reasonable estimations of these costs in disclosures to clients (rather than simply state they are not currently available);
- ensure that the effect of commissions, fees or other charges are disclosed when presenting performance information to clients;
- refrain from using the term 'independent financial advice' (or related terms) where they accept and retain commissions from third parties;
- when providing independent financial advice, to disclose to clients certain information regarding the factors taken into consideration in the product selection process which leads up to a recommendation, covering such factors as risk, costs and

product complexity and also to conduct the selection process in accordance with specified MiFID criteria;
- where the firm is a natural person, refrain from providing both independent and non-independent advice; and
- ensure that they do not remunerate or assess the performance of their staff in a way that conflicts with their duty to act in the best interests of their clients, for example by remunerating its staff solely or predominantly based on quantitative commercial criteria or not maintaining a balance between fixed and variable components of remuneration at all times.

Authorisation (IIA) requirements
In addition, the following amendments will be made to the Investment Intermediaries Act 1995:

- firms seeking authorisation under Section 10 (meeting the Article 3 (1) (a)-(c) conditions) shall provide additional information regarding the management body and resources of the firm, such information to be provided prior to the granting of authorisation; and
- the Central Bank shall establish a public register of tied agents (for Article 3 (1) (a)-(c) firms), restricting such firms from appointing tied agents to those that are on that register, and requiring firms to monitor the activities of their tied agents in accordance with Article 29 MiFID (without prejudice to the fact that the activities of the tied agent when acting on behalf of the firm are to remain under the full and unconditional responsibility of the firm).

The Minister welcomes the new legislative framework in respect of firms meeting the conditions in Article 3 (1) (a)-(c) as it will serve to improve consumer protection in relation to retail investment products while providing for proportionate treatment for the relevant investment service providers, who otherwise would be subject to the full MiFID rulebook.

Question 1c – Whether to exempt persons from the MiFID 2 regulations meeting the conditions set out in Article 3(1) (d) or (e), insofar as permitted by Article 3(2)

Two respondents from the energy sector were in favour of this exemption, with competition grounds cited as the rationale for the Minister to exercise the discretion. No respondent indicated that they would actually seek to avail of this exemption.

The Minister has decided not to exempt firms qualifying under paragraphs (d) or (e) as he has not received compelling evidence as to why this is necessary or would be the best course of action. The Minister understands that many energy undertakings active in derivative and/or emission allowance markets in the EU will be in a position to avail of a *full* exemption from MiFID rules under Article 2, in particular via the 'ancillary activity' exemption described in point (j).

Optional Exemptions and Investor Compensation Scheme

Question 2 – To retain the requirement that all investment firms, regardless of any exemption enjoyed by virtue of Article 3 (1), should be covered by the investor compensation scheme.

This concerns the national discretion in *Article 3(2) second final subparagraph* MiFID 2. A large majority of respondents who addressed this question favour the retention of this obligation in order to maintain the current regime and protect investors. Two respondents made supplementary points regarding improvements to the operation of the Investor Compensation Scheme.

In the interests of investor protection, the Minister will exercise this discretion to maintain the requirement that all investment firms, regardless of any Article 3(1) exemption, are covered by the investor compensation scheme.

Investor Protection, including Conflicts of Interest

Article 24(12) and Articles 22(3) & 29(3) of the Insurance Distribution Directive (IDD) provide national discretions, including in relation to conflicts of interest & inducements. The public consultation requested views on whether level playing field rules should apply between different types of distributors/financial advisors. In this regard, it is noted that Article 22(3) of IDD concerns the sale of general insurance products as well as insurance based investment products.

Question 3a & b –Whether to provide for level playing field rules in relation to the distribution of, and advice on, functionally equivalent retail investment products.

On balance, respondents who addressed this question favoured a level playing field approach for consumer protection reasons. Two respondents who did not favour a level playing field approach cited differences between MiFID and insurance based investment products which in their view justifies a differentiated approach.

Question 3c - Options to best address the interests of retail investors

Option 1: Not exercise the discretion but delegate the discretionary powers to the NCA
Two respondents favoured this option, though one of these stated there still needs to be a thorough investigation of this area based on suggested criteria (a) to (h), in conjunction with industry consultation.

Option 2: Request the NCA to conduct a detailed assessment in this area in advance of any decision whether and how to exercise the national discretion(s) and whether there is agreement with the suggested criteria (a) to (h) as outlined in the document.
Four respondents favoured Option 2, agreeing with the suggested criteria (a) to (h). One respondent suggested that it is appropriate that the Minister has strong oversight here.

The Minister notes the majority of respondents who addressed this question supported a level playing field approach and considers that different standards applicable to different types of intermediaries selling functionally equivalent products runs the risk of creating competitive distortions, leaving certain consumers in a more vulnerable position.

As an intermediary decision, the Minister pursued Option 2 presented in the public consultation. The Minister requested that the Central Bank, based on the criteria specified in the consultation document, provide him with a report for the purpose of informing his decision on whether the discretions provided in Article 24(12) of MiFID and Articles 22(3) and 29(3) of IDD should be exercised, and if so in what manner.

The Minister and his officials, having considered the contents of this report, has decided not to exercise the discretions provided in Article 24(12) of MiFID, at least not at this point in time.

Further consideration will be given following the outcome of a Central Bank public consultation on the payment of commission to intermediaries later in the year. The Minister and his officials are still considering the contents of the Central Bank report from the perspective of the relevant national discretions contained in *IDD*, including where it addresses level playing field issues and the use of the "independent financial advice" label.

Client Order Handling Rules

Question 4 – To enable investment firms to fulfil their obligation in regard to the earliest possible execution of client orders by transmitting the client limit order to a trading venue.

This concerns the national discretion in *Article 28(2)* MiFID 2. All respondents who addressed this issue were in favour of this discretion in order to maintain the current regime and to promote transparency and best execution. In the absence of any evidence that the current regime is sub-optimal, the Minister has decided to follow the same approach taken in MiFID 1 and exercise this discretion.

Third Country Firms and Branches

Question 5a - To apply a third country branch requirement in relation to investment services to retail or elective professional clients.

This concerns the national discretion in Article 39(1) MiFID 2. Two respondents were against exercising this discretion stating that there are cost and competitive disadvantages, without providing commensurate consumer protection benefits. However, there was very little elaboration on what cost and competitive disadvantages could arise and who might bear the burden.

A respondent cited the case of 'elect-up professional investors', who, through the qualifying criteria are deemed to be more experienced than the average retail investor. One respondent was in favour of exercising the discretion without elaborating, while two respondents requested further discussion on the matter.

The Minister has decided to exercise the discretion to impose a branch requirement when a third country firm intends to provide investment services to retail and elect-up professional clients in the State.

Factors which have influenced this decision are that such a requirement provides greater protection for retail clients (including through recourse to the Financial Services Ombudsman, to the Investor Compensation Scheme or an equivalent scheme, etc.) and ensures level playing field rules vis-à-vis investment firms that currently provide retail investment services in the State. The Minister understands that this is the common approach which most Member States intend to adopt.

The Minister notes that in the case of 'elect-up professional investors' there is a conscious choice to 'elect-up', and further notes that the reverse solicitation rule in Article 42 MiFID 2 sets out the conditions under which retail and 'elect-up professional investors' can continue to transact with third country investment service providers other than through a local branch.

Question 5b –To establish a third country branch regime to facilitate the provision of wholesale investment services (services to per se professional clients and eligible counterparties) on a branch basis.

The Minister has decided to substantially maintain the current national regime for third countries as it concerns the provision of wholesale investment services. In this regard the Minister wishes to ensure that the safe harbour provided to third country investment firms by Regulation 8 of SI 60/2007 will generally remain. However, to take account of changes to the legislative framework and address certain concerns arising, the safe harbour will no longer apply in the following circumstances:

- if the firm provides investment services to retail or elect-up professionals in the State. This is a consequence of the decision to require a branch under Article 39 MiFID. It means that the reference in the current Regulation 8(2) of SI 60/2007 to *"individuals in the State who do not themselves provide one or more investment services on a professional basis"* must be amended accordingly[2];
- if the firm is registered by ESMA in accordance with Article 47 MiFIR. This is a consequence of the fact that the MiFIR third country regime supersedes any national regime at the point where a firm goes onto the ESMA register following a Commission equivalence decision in respect of the home country of the firm. In essence, the safe harbour still exists but under the MiFIR framework rather than the national one and in that respect it applies throughout the Union;
- in respect of third country firms whose home country is on the FATF list of non-cooperative jurisdictions[3] and which is not subject to authorisation and supervision

[2] A further consequence of this decision is that the non-application of MiFID to branches of third country investment firms (per Regulation 5(1)(r) of SI 60/2007) will be modified to take account of the fact that third country investment firms wishing to offer retail investment services in the Irish market will be required to do so on a branch basis.

[3] See http://www.fatf-gafi.org/countries/#high-risk

in respect of the investment services provided to wholesale clients in the State (corresponding to the conditions in Article 39(2)(a) of MiFID); and

- in respect of third country firms whose home country is not a signatory to the IOSCO Multilateral Memorandum of Understanding concerning consultation and cooperation and the exchange of information[4] (corresponding to the condition in Article 39(2)(b) of MiFID).

Additionally, where ESMA withdraws the registration of a third country firm in accordance with Article 49 MiFIR the Central Bank will be empowered to align with ESMAs decision in respect of that firm.

Higher fees applying to cancelled orders:

Question 6 – To provide regulated markets with the flexibility to impose a higher fee in relation to cancelled orders

This concerns the national discretion in *Article 48 (9) third subparagraph* MiFID 2. A large majority of respondents who addressed this question favoured exercising this discretion for investor protection reasons, at least in relation to high frequency trading. One respondent opposed it as it may have the effect of inhibiting market making strategies. The Minister has decided to exercise this discretion by allowing regulated markets to impose higher fees for cancelled orders and on participants placing a high ratio of cancelled orders to executed orders. The Minister considers that providing the regulated market with this type of flexibility is a prudent response to reflect any additional resulting burden on system capacity and to further mitigate against any risk to the maintenance of an orderly market.

Designation of National Competent Authorities

Question 7 – To designate the Central Bank of Ireland as the single National Competent Authority.

This concerns the national discretion in *Article 67(1)* MiFID 2. All submissions on this question favoured the designation of the Central Bank of Ireland as the single National Competent Authority. The Central Bank of Ireland will be designated as the single national competent authority.

Sanctions

Question 8a - To provide for criminal sanctions.

Three respondents addressed this question. All were in favour of exercising the discretion. One respondent stated that the Department should review the current list of MiFID 1 infringements subject to criminal sanction to ensure that only infringements which are outside of the Central Bank's Administrative Sanctions Procedure are captured. The Minister has decided to provide for criminal sanctions in respect of infringements of MiFID 2 (per the

[4] See Appendix A of https://www.iosco.org/about/?subSection=mmou&subSection1=signatories

current maximum penalties in section 5(3) of the Markets in Financial Instruments and Miscellaneous Provisions Act 2007) and his officials will advise in relation to the precise list of infringements, broadly based on the approach set out in the public consultation. This will require primary legislation and as such can be expected to follow the transposing regulations.

Question 8b – To adopt the €5 million maximum fine for natural persons and the disgorgement amount, but increase to €10 million the maximum fine for legal persons.

This concerns the national discretion in *Article 70(1) & (7)* MiFID 2. No respondents who addressed this question disagreed with the proposed maximum fines and disgorgement amount. The Minister has decided to exercise the discretions by setting maximum fines as proposed in the public consultation. In exercising this discretion the Minister is aligning with the Central Bank's Administrative Sanctions Regime.

Other

Question 9 – To identify any other Member State discretions or issues related to the transposition of MiFID 2.

There were no further Member State discretions identified by respondents.

Client Asset Rules

Under MiFID 1 Regulations (S.I. No. 60/2007) there is a Member State discretion to go beyond the *client asset rules* provided for in the Directive. Ireland exercised this discretion via the Central Bank (Supervision and Enforcement) Act 2013 (Section 48(1)) Client Asset Regulations 2015 for Investment Firms (S.I. No. 104/2015). In line with the general approach which we outlined in the Public Consultation, we intend to maintain the domestic Central Bank Client Asset Regulations and to this end have received the approval of the European Commission in accordance with Article 16(11) MiFID 2.

These regulations are a <u>maintenance</u> of the current domestic Client Asset Regulations, with some amendments to reflect the fact that the MiFID 2 level 2 rules are detailed and to some extent overlap with S.I. No. 104/2015. The amended Client Asset Regulations will not form part of the transposing MiFID 2 Regulations but will be in the form of a separate S.I. made by the Central Bank under the framework provided in the Central Bank Supervision & Enforcement Act 2013. The Central Bank will consult with industry on the regulations and it is our expectation that the revised domestic client asset regulations will be in place by 3 January 2018.

S.I. No. 60 of 2007

The Regulations transposing MiFID 1 contain several provisions for which there are no direct corresponding obligations in MiFID 1 or indeed MiFID 2. The position in regard to Regulation 5(1)(r) and Regulation 8 of SI 60/2007 has already been addressed in the section on the third country regime.

The more prescriptive framework in MiFID 2 means that certain regulations in SI 60/2007 will not be carried across to the Regulations transposing MiFID 2 as they are no longer necessary in light of the relevant MiFID 2 provisions. In other cases, Regulations may concern regulatory powers which are already available to the Central Bank through the Central Bank Acts or regulations made thereunder. For example:

- certain Regulations relating to the safeguarding of client assets and disclosures thereon have been superseded;
- certain Regulations transposed requirements from MiFID 1 are now set out in direct effect EU Regulations (i.e. MiFIR or MiFID level 2 Regulations); and
- the discretion provided to the Central Bank to impose additional requirements in relation to conflicts of interest/inducements/client disclosures (Regulation 79) will be a discretion given to the Minister in line with the Ministers decision on Article 24(12) MiFID 2.

Certain provisions from SI 60/2007 will be carried across (with any necessary modifications) to the Regulations transposing MiFID 2. Some examples include:

- exemptions in Regulation 5(1)(q),(m) & (n) and 5(4) will be retained;
- transitional provisions will be retained to ensure that existing MiFID firms do not have to undergo an authorisation process under MiFID 2;
- transitional provisions will be retained to enable the Central Bank to proceed with enforcement actions under SI 60/2007 after this SI has been revoked;
- powers of the Central Bank to seek revocation of authorisation through the courts (with additional grounds as specified in SI 60/2007) will be retained; and
- powers of a liquidator, receiver, etc., including restrictions thereon (Regulation 157 & 158) will be retained.

Provisions prohibiting persons knowingly or misleadingly making false or misleading applications for any type of authorisation covered by MiFID 2 will be retained in the Regulations or else will be covered under primary legislation providing for indictable criminal penalties – the effect being the same. Similarly, in regard to the prohibition against misappropriation of client monies or assets will be retained.

Enforcement regime for non-regulated persons

Unlike MiFID 1, MiFID 2/MiFIR applies or may apply to certain non-regulated persons (e.g. Title V MiFIR as it refers to “non-financial counterparties”). The assessment regime (based on the Regulations transposing EMIR) will be the applicable enforcement regime for any such non-regulated persons.

Interaction of MiFID 2/MiFIR & EMIR – fx forwards

Due to the lack of specificity in the definition of foreign exchange forward derivative contract ("fx forward") in the MiFID 1 framework, Member States interpreted the term in different ways. Following discussions between the Commission and EU policy makers in the context of EMIR, it was resolved that a harmonised definition of fx forward would be required under the MiFID 2 framework.

Article 10 of the MiFID Commission Delegated Regulation 2017/565 of 25 April 2016 – published in the Official Journal of the EU on 31 March 2017 - describes a fx forward. This definition, for the purpose of EMIR, will come into effect as at the date of entry into force of MiFID II.

Technical drafting

Technical drafting will reflect the decisions on the national discretions and is currently being finalised.

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