

**EXPLANATORY MEMORANDUM TO**  
**THE FINANCIAL SERVICES AND MARKETS ACT 2000 (MARKETS IN**  
**FINANCIAL INSTRUMENTS) REGULATIONS 2017**

**2017 No. 701**

**1. Introduction**

- 1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.
- 1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

**2. Purpose of the instrument**

- 2.1 These Regulations transpose Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (recast) (OJ L173, 12/6/2014, p.349) (“MiFID II”). In addition they contain provisions to give effect to Regulation (EU) No 600/2014 of the European Parliament and Council on markets in financial instruments (OJ L 173, 12.6.2014, p. 84) (MiFIR). MiFID II and MiFIR together replace and extend Directive 2004/39/EC of the European Parliament and Council of 21 April 2004 on markets in financial instruments (OJ No. L145, 30.4.2004 p.1) (“MiFID I”).

**3. Matters of special interest to Parliament**

*Matters of special interest to the Joint Committee on Statutory Instruments*

- 3.1 These Regulations are laid on 22<sup>nd</sup> June and enter into force on 3<sup>rd</sup> January 2018. However, some provisions come into force on 3<sup>rd</sup> July for the purpose of allowing the regulators and the public to make preparations for when the Regulations come fully into force (see regulation 2). For the provisions subject to early commencement, HM Treasury is allowing less than the minimum 21 day period applying by convention between the laying of a statutory instrument subject to the negative resolution procedure in Parliament and its coming into force. The unexpected timing of the general election and the consequent dissolution of Parliament on 3 May meant that these Regulations could not be laid as planned. In light of HM Treasury’s obligation to transpose MiFID II into UK law by 3<sup>rd</sup> July 2017, and to ensure that the Financial Conduct Authority (“FCA”) has the necessary powers to make associated required rule changes, it was not feasible to delay the coming into force date to comply with the 21 day rule. HM Treasury apologises for the inconvenience caused by reducing the time available to the Committee to consider the provisions of the Regulations coming into force on 3<sup>rd</sup> July 2017.

*Other matters of interest to the House of Commons*

- 3.2 As this instrument is subject to the negative procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

#### **4. Legislative Context**

- 4.1 The United Kingdom is required to put in place domestic legislation to implement MiFID II by 3<sup>rd</sup> July 2017 and MiFIR by 3<sup>rd</sup> January 2018. These Regulations are one of three statutory instruments implementing MiFID II and MiFIR. The other instruments are the Data Reporting Services Regulations 2017 (which are being made in parallel with these Regulations) and the Financial Services and Markets Act 2000 (Regulated Activities)(Amendment) Order 2017 (S.I. 2017/488) (which was made on the 28<sup>th</sup> March 2017). The FCA and Prudential Regulatory Authority (“PRA”) are also making rules to implement MiFID II and MiFIR.
- 4.2 MiFID II and MiFIR, which replace MiFID I, set the EU wide regulatory regime for both firms providing investment services relating to financial instruments (such as shares, futures, and derivatives) and for financial markets. These Regulations implement a variety of requirements imposed on the United Kingdom under MiFID II and also contain provisions to ensure United Kingdom law gives full effect to MiFIR.
- 4.3 Part 1 of these Regulations designates the FCA, PRA, and Bank of England as competent authorities to carry out the duties set out in Titles I to IV, VI and VII of MiFID and in MiFIR.
- 4.4 Article 3 of MiFID II allows Member States to choose not to apply the directive to firms for which they are the home Member State provided their national law imposes certain condition on those firms. Chapter 1 of Part 2 of the Regulations gives effect to Article 3 and enables investment firms authorised in the United Kingdom to be exempt from the requirements of MiFID II, subject to various restrictions.
- 4.5 Chapter 2 of Part 2 contains provisions concerning third country (non-EU) firms providing investment services in the EU. These provisions are intended to give effect to the directly applicable rules on such firms in Title VIII of MiFIR (which give access to the UK for such firms if the Commission decides their home State has a regulatory regime equivalent to the EU’s regime). The FCA is also given powers to intervene in these firms.
- 4.6 Part 3 implements Article 57 of MiFID II, which requires Member States to both put in place limits on the size of positions that can be held in commodity derivatives and to enforce position limits put in place by other Member States.
- 4.7 Part 4 imposes controls relating to algorithmic trading etc. on certain firms and individuals, such as insurance undertakings, that are otherwise exempt from MiFID II, in order to implement Article 1.5 of the directive.
- 4.8 Part 5 gives the FCA and PRA powers to remove a person from the management board of an investment firm, credit institution, or recognised investment exchange, for the purposes of MiFID II. This is to implement Article 69.2(u) of MiFID II (Article 69 lists the supervisory powers competent authorities must have to carry out their duties under MiFID II and MiFIR).
- 4.9 Part 6 contains a number of miscellaneous provisions relating to MiFID II and MiFIR, such as duties to inform ESMA of certain matters relating to the Directive or Regulation. Part 7 contains further miscellaneous provisions dealing with the transition to the new regime under MiFID II and MiFIR, amendments to legislation and the review of these Regulations.
- 4.10 Schedules 1, 2, and 3 contain modifications and amendments to the Financial Services and Markets Act 2000 and secondary legislation made under that Act. These give the

FCA and PRA powers to supervise and enforce both these Regulations and MiFID II and MiFIR. The amendments also implement various provisions of MiFID II via changes to existing financial services legislation (much of which implemented MiFID I): more detail is available in the transposition note. Schedules 3 and 4 contain consequential amendments to other primary and secondary legislation resulting from the replacement of MiFID I by MiFID 2 and MiFIR.

- 4.11 Prior to agreement in Council, MiFID II and MiFIR were submitted to Parliament for scrutiny. They were cleared by the House of Lords European Scrutiny Committee on 27 February 2013, and were cleared by the House of Commons Scrutiny Committee after a debate on the same day.
- 4.12 MiFID II and MiFIR were the subject of the House of Lords European Union Committee's second report of the 2012-13 session (HL28), "*MiFID II: Getting it Right for the City and EU Financial Services Industry*". The report was debated in a Motion to Take Note, moved by Lord Harrison on 26 March 2013 (Hansard volume 744). In its response, the government welcomed the report, and set out how it would take the recommendations forward.
- 4.13 A transposition note showing how these Regulations transpose MiFID II is published on [legislation.gov.uk](http://legislation.gov.uk).

## **5. Extent and Territorial Application**

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

## **6. European Convention on Human Rights**

- 6.1 The Chancellor of the Exchequer has made the following statement regarding Human Rights:

"In my view the provisions of the Financial Services and Markets Act 2000 (Markets in Financial Instruments) Regulations 2017 are compatible with the Convention rights."

## **7. Policy background**

### *What is being done and why*

- 7.1 The instrument forms part of the transposition into UK law of MiFID II and also gives effect to MiFIR. MiFID II and MiFIR update MiFID I in light of the financial crisis and technological change.
- 7.2 MiFID II and MiFIR create more robust and efficient market structures, and require more trades to be conducted through trading venues in order to promote transparency. They will introduce new safeguards for algorithmic and high frequency trading, and improve competition in essential post-trade services such as clearing. They will provide a stricter framework for commodity derivatives and strengthen investor protection. The aims of the EU legislation are consistent with our overall approach to the regulation of financial markets in the UK.
- 7.3 On 23 June, the EU referendum took place and the people of the United Kingdom voted to leave the European Union. Until exit negotiations are concluded, the UK remains a full member of the European Union and all the rights and obligations of EU

membership remain in force. During this period the Government will continue to negotiate, implement and apply EU legislation. The outcome of these negotiations will determine what arrangements apply in relation to EU legislation in future once the UK has left the EU.

- 7.4 These Regulations transpose parts of MiFID II relating to position limits and management controls on holdings of commodity derivatives, the conduct of firms providing direct electronic access or conducting algorithmic trading, the requirements for market operators running Organised Trading Facilities, a new type of trading venue created by MiFID II, and investment services provided by firms from third countries with equivalent regulatory regimes. They also provide regulatory authorities with enforcement and investigatory powers.
- 7.5 At the Pittsburgh summit in September 2009, the G20 committed to improving the functioning of markets in commodity derivative contracts. The EU took this commitment forward in MiFID II. These Regulations provide for the FCA to impose limits on the positions persons may hold in commodity derivatives, and also provide powers for the FCA or trading venues to limit the ability of a person to enter into a contract for a commodity derivative, restrict the size of position a person may hold in such a contract, or require a person to reduce the size of a position held in a commodity derivative.
- 7.6 In recent years, concerns have been raised about the systemic risk caused by firms conducting trading using computerised algorithms. In particular, these risks relate to the sudden disappearance of liquidity in stressed conditions. These Regulations introduces certain requirements in MiFID II particular to algorithmic trading firms, including introducing minimum standards for system resilience and record-keeping. Record-keeping accuracy is also increased through requirements for the synchronisation of business clocks. In order to preserve liquidity in stressed conditions further, these regulations contain requirements set down in MiFID II for firms pursuing market making strategies to enter into written agreements with trading venues.
- 7.7 MiFID II permits firms from third countries whose financial services regulatory regimes have been judged to be equivalent in relevant aspects to the EU's to provide cross-border investment services to qualified clients in the EU. These Regulations permit such firms to provide services via this route without the need for further authorisation by UK regulators.
- 7.8 The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2017 (S.I. 2017/488) transferred regulation of binary options from the Gambling Commission to the FCA. These Regulations provide, where appropriate, for the refund of fees paid to the Gambling Commission by firms offering binary options.
- 7.9 These regulations finally provide for enforcement and investigatory powers in relation to MiFID II and MiFIR, following either the minimum standards set down in MiFID II, or the status quo in existing financial services legislation.

#### ***Consolidation***

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

## **8. Consultation outcome**

- 8.1 The Treasury ran a public consultation on the transposition of MiFID II which opened on 27 March 2015 and closed on 18 June 2015. The consultation focussed on the regime for firms from non-EU countries; data reporting services providers; position limits and reporting in commodity derivatives; the regime for unauthorised persons; the regulation of structured deposits; the ability of regulators to remove board members; OTFs; and binary options.
- 8.2 The Treasury received over 30 responses to the consultation document. It has examined and considered each carefully.
- 8.3 Respondents broadly or unanimously agreed with the Treasury's proposed positions on almost all issues.
- 8.4 The majority of substantive issues raised related to provisions to be found in the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2017, or the Data Reporting Services Regulations 2017. These are referred to in the respective explanatory memoranda.
- 8.5 Where there was confusion about definitions or rules, the Treasury, in liaison with the European Commission, has provided clarification.
- 8.6 A more detailed analysis of the consultation outcome and the Treasury's policy response to the opinions expressed can be found at:  
<https://www.gov.uk/government/consultations/transposition-of-the-markets-in-financial-instruments-directive-ii>.

## **9. Guidance**

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

## **10. Impact**

- 10.1 The Impact Assessment states that the transposition of MiFID II and MiFIR will have an estimated annual net cost to business of £148.5 million. The Treasury do not believe that there will be any impact on charities or voluntary bodies stemming from this SI.
- 10.2 The Treasury do not believe that there will be any impact on the public sector stemming from this SI.
- 10.3 An Impact Assessment is submitted with this memorandum and is published alongside the Explanatory Memorandum on the legislation.gov.uk website.

## **11. Regulating small business**

- 11.1 These Regulations apply to activities that are undertaken by small businesses to the extent that they are investment firms or otherwise caught. However, HMT expects the impact on small and micro-business to be relatively light, as set out in the impact assessment.

## **12. Monitoring & review**

- 12.1 The instrument contains a requirement for the Treasury to review the legislation, every five years, and set out the conclusions of each review in a published report. The first report, to be published in the five year period beginning from 3<sup>rd</sup> July 2017, will set out the objectives intended to be achieved by the regulatory provision.

## **13. Contact**

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