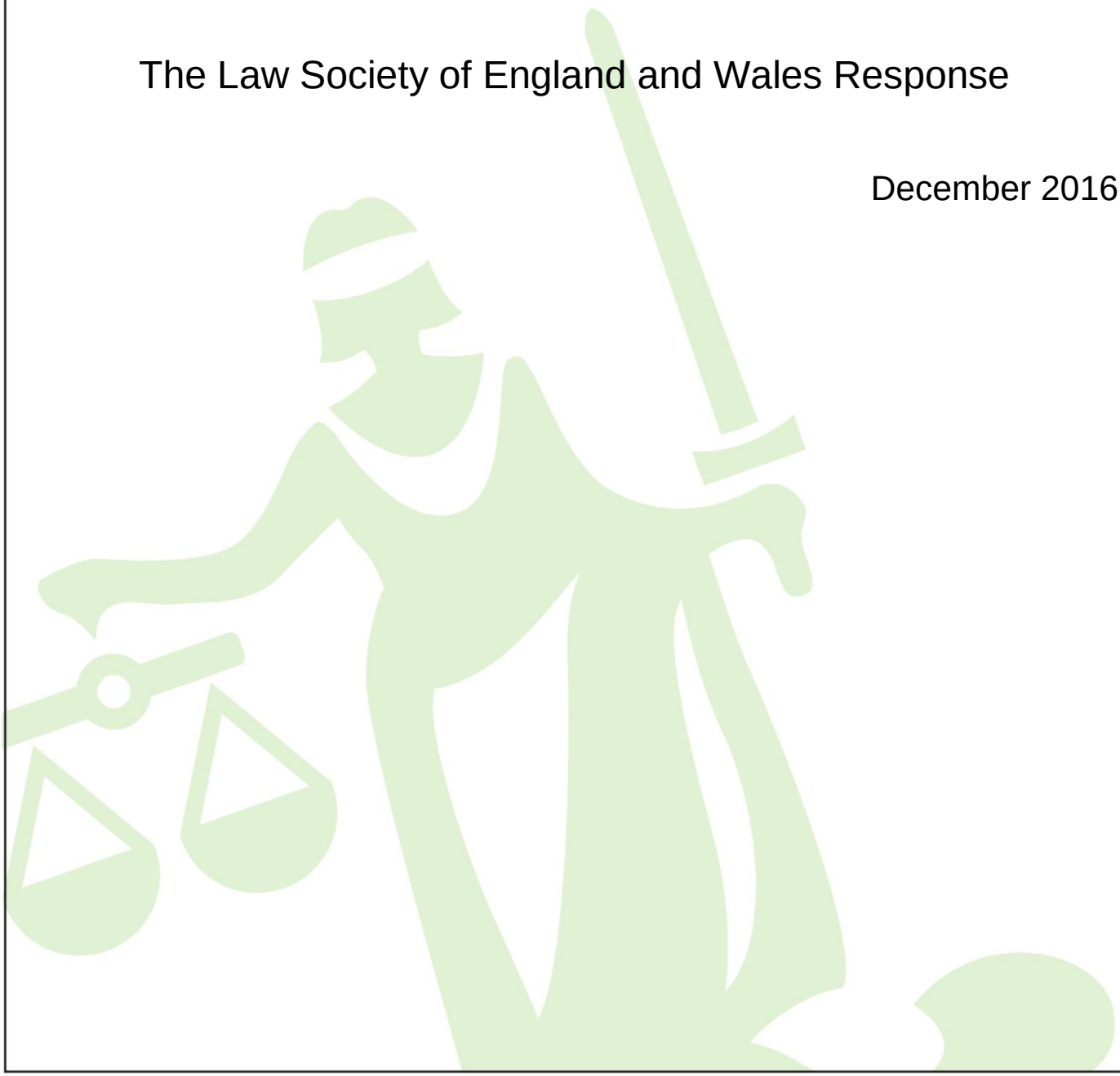
HM Treasury: Amending the definition of financial advice

The Law Society of England and Wales Response

December 2016



Contents

1. INTRODUCTION

1.1. The Law Society of England and Wales is the representative body of over 160,000 solicitors in England and Wales. The Society negotiates on behalf of the profession and makes representations to regulators and Government in both a Domestic and European arena. This response has been prepared by the Society's standing committee on Company Law. The Committee is made up of senior and specialist corporate and financial services lawyers.

1.2. The Law Society welcomes the opportunity to respond to HM Treasury's consultation Amending the Definition of Investment Advice (the "Consultation"). We have set out below our comments below.

1.3. Terms defined in the Consultation have the same meaning in this response.

2. RESPONSES TO CONSULTATION QUESTIONS

Q1. Is the proposed wording a suitable and effective way to achieve the stated policy objective? Is there anything else needed in drafting terms in order to achieve the policy objective…?

2.1. We support the policy objective of appropriate regulatory simplification. Financial services legislation is extremely complex even for those who practise in the area and almost certainly very difficult to comprehend for others who come across it rarely. Our October 2014 response to the FCA's Guidance Consultation (GC14/3) "clarifying the boundaries and exploring the barriers to market development" set out some of the issues we saw as arising from that part of paragraph 53 RAO which goes beyond a "personal recommendation".

2.2. Subject to two substantive comments and one drafting comment set out below, our answer to the first question in the Consultation is yes.

2.3. We suggest that proposed paragraph 53(1) in the revised text for article 53 of the Regulated Activities Order should read as follows (our amendments are marked):

"(1A) A personal recommendation is a recommendation —

(a) ~~a recommendation~~ made to a person in that person's capacity as an investor or potential investor, or in that person's capacity as agent for an investor or a potential investor;

(b) ~~a recommendation that that person does~~ on the merits of a person doing any of the following (whether as principal or agent) —

(i) buying, selling, subscribing for or underwriting a particular investment which is a security or a relevant investment, or

(ii) exercising any right conferred by such an investment to buy, sell, subscribe for or underwrite such an investment; and

(c) ~~a recommendation~~ that is —

(i) presented as suitable for the person to whom it is made, or

(ii) based on a consideration of the circumstances of that person.

(1B) A recommendation is not a personal recommendation if it is issued exclusively —

~~•(a) through distribution channels; or~~

~~•(b)~~ to the public."

2.4. The drafting comment is self-explanatory. The first substantive comment is that we consider that it would be preferable to make clear that a personal recommendation includes a recommendation *not* to buy or sell etc. (and, thus, to hold investments – see paragraph 2.5) [1]. Accordingly, a personal recommendation should be a recommendation "*on the merits*" of buying or selling etc., as is the case for advice under paragraph 53 RAO. A recommendation simply that a person "buys or sells etc." does not, in our view, clearly capture a recommendation not to buy or sell etc., or to hold investments. The second substantive comment is that the definition of "personal recommendation" should match the updated definition in the Revised Markets in Financial Instruments Directive (2014/65/EU) (MiFID 2) rather than that in MiFID.

2.5. As regards the second question, we suggest that, in its perimeter guidance, the FCA makes clear that this definition, which uses the words "buy, sell, subscribe for or underwrite…" rather than those used in MiFID 2 (and the relevant delegated act to be made under it), encompasses[2] all the activities set out in the definition of "personal recommendation" in that delegated act, namely to buy, sell, subscribe for, exchange, redeem, hold or underwrite or to exercise or not to exercise any right conferred by a particular financial instrument to do one of those things.

3. OTHER POTENTIAL AREAS OF REGULATORY SIMPLIFICATION

3.1. The RAO is a very complicated piece of legislation. The difficulty of interpreting it increases with every significant amendment made to it and, most particularly, with the approach of retaining the shape of financial services, banking, insurance and consumer credit legislation first set out in UK statutes thirty or more years ago and bolting into it activities which are required to be regulated under EU regulation. The legislative changes that will be necessary to implement Brexit (whatever shape it takes) provide an opportunity to re-consider this legislative approach in areas where there is overlap. In order to decide whether authorisation is required under the Financial Services and Markets Act 2000 (FSMA) it is necessary to follow a two stage process and ask (1) is this activity regulated under UK legislation implementing the relevant directive and (2) if not, is the activity regulated under the wider scope of the retained UK legislation?

[1] We note that the CESR Q&A "Understanding the definition of advice under MiFID" of April 2010 (CESR/10-293) indicated that a recommendation not to buy a financial instrument can also constitute the provision of a personal recommendation for the purposes of MiFID (paragraph 31). The definition of personal recommendation under MiFID 2 has not changed in any way which is relevant to that guidance.

[2] Which we consider it would, as a matter of interpretation, and through the relevant definitions and interpretational provisions in the RAO, subject to the first substantive comment referred to in paragraph 2.4 above.

3.2. In particular and focussing mainly on investment services and activities, the following questions spring to mind[3]:

(a) The "by way of business" threshold test for investment services and activities in article 3 of the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 (the "Business Order") is easier to fulfil than the "regular occupation or business" test in MiFID 2, which is a sub-set of the test in the Business Order. As a result, there are, for example, exclusions to allow a company to issue or repurchase its own shares (paragraphs 18, 18A and 34 RAO), for trustees (paragraph 66 RAO), for activities carried on connection with the sale of goods or the supply of services (paragraph 68 RAO) and (broadly) for the transfer of control of a body corporate (paragraph 70 RAO) . The scope of activities required to be regulated by MiFID 2 is far wider than the scope of activities which were required to be regulated under the Investment Services Directive, the directive in force at the time the RAO and the Business Order came into force. In our view, it makes sense to review whether the test in article 3 of the Business Order provides meaningful additional investor protection in relation to activities which fall within MiFID 2 (see further (b) to (e) below).

(b) Dealing as principal (paragraphs 14 to 20 RAO). The broadly equivalent MiFID 2 investment service/activity is dealing on own account[4]. When the exclusions specific to this activity[5] in article 2 of MiFID are taken into account those who are required to be regulated are those who trade against proprietary capital resulting in the conclusion of transactions:

(i) in one or more financial instruments not falling within (ii):

- as a marketmaker; or
- as a member of or participant in a regulated market or a multi-lateral trading facility (***MTF)***; or
- using direct electronic access to a trading venue (i.e. a regulated market, MTF or organised trading facility (***OTF***); or
- using a high frequency algorithmic trading technique (this applies also where the instruments fall within (ii)); or

[3] Many of them make the assumption that, following Brexit, at least in terms of regulatory perimeter, the UK will not wish to regulate fewer activities than it is required to do by MiFID 2 and the other financial services directives and regulations. We have not addressed the investment services of discretionary management and investment advice because the scope of the first is, and the second will be, the same as under UK legislation.

[4] PERG 13.3 questions 15 and 16 indicate that matched principal or riskless principal trading, which fall within paragraph 14 RAO, are equivalent to the MiFID 2 activity of executing orders on behalf of clients. Under MiFID 2 the issue by an investment firm or a credit institution of its own financial instruments to clients is also included in the executing orders service but, under the RAO, falls within paragraph 14. Elements of placing or underwriting on a firm commitment basis also fall within paragraph 14. These three examples highlight a further difficulty with the current mismatch between the RAO and investment services and activities as specified in MiFID 2.

[5] There are other exclusions – for example, for activities performed for group members and for those carried out by professionals as ancillary to their main business, which are not referred to here.

- by dealing on own account when executing client orders; or
- as a person who also provides other investment services in relation to those financial instruments; or

(ii) in commodity derivatives, emission allowances or related derivatives where their trading falls below specified thresholds and they have met certain notification requirements.

Against this background it is hard to see that that part of paragraph 14 which falls outside the MiFID activity minus the exclusions in paragraphs 15 to 20 RAO (and especially those in paragraphs 15 and 16) adds meaningfully to investor protection.

(c) Dealing as agent (paragraphs 21 to 24 RAO). The broadly equivalent MiFID 2 investment services are execution of orders on behalf of clients and potentially certain elements of placing or underwriting of financial instruments (with or without a firm commitment). In relation to execution of orders, there is a similar exclusion in MiFID 2 to that described in (b), but otherwise this activity is required to be regulated to the extent the "regular occupation or business" test is fulfilled. Again, it is hard to see what investor protection is added by that part of paragraph 21 which falls outside the MiFID 2 activities (as cut back by the exclusions in paragraphs 22 to 24 RAO) adds in terms of investor protection..

(d) Arranging deals in investments (paragraphs 25 and 25D and related exclusions). This is one of the most wide-ranging regulated activities. It encompasses the MiFID 2 activities of receipt and transmission of financial instrument orders, elements of placing and underwriting (again with or without a firm commitment), operation of an MTF, operation of an OTF and operation of a regulated market[6]. The paragraph 25 penumbra of activities regulated in the UK, but not in the EU, may perhaps have more substance than those considered in (b) and (c), but it is still worth asking the question whether the complexity of having to look at the same activities in two different ways to decide whether authorisation is required is really justified. Is it really helpful for the kind of consumers whom HMT has identified in the Consultation Document are in need of help for it potentially to be regulated business to assist them in filling in, or checking, an application form (see PERG 2.7.7BF and 5.6.4G)?

(e) given the EU concepts of UCITS and AIF, is it really necessary to have a separate definition in the FSMA of "collective investment scheme" or the related restriction on promotion in section 238 FSMA?

(f) the territorial application of the legislation needs to be clear. In particular, this is not so for the activities of deposit-taking and insurance where the position is set out in case law. Some clarity is provided by paragraph 72 RAO, although further examination and codification of the place of characteristic performance may make sense in the context of Brexit in terms of clarity about when a passport or equivalence ruling is actually required either by a UK

[6] An activity which is regulated somewhat differently under mifid2 from other investment services and activities.

based business or by a business in one of the EU27 seeking to do business into the UK.

(g) an entire chapter of PERG is required to make the financial promotion regime established under section 21 FSMA comprehensible and, to the extent it is, workable. There is no clear exemption for reverse solicitation nor to allow the solicitation of ex-patriates by regulated businesses from their home jurisdictions.

FOR FURTHER INFORMATION

Officer's Name : Olu Oluwole
Officer's Title : Policy Adviser
Officer's Email address : Olufola.Oluwole@LawSociety.org.uk
Officer's Telephone number : 02073205782