

Classification of Investment Firms under MiFID and the CRD

Introduction

By default, all investment firms including, are covered by the Markets in Financial Instruments Directive (MiFID) and the Capital Adequacy Directive (CAD). However, exemptions do exist to give certain types of investment firms opt outs from both Directives.

Classification

All investment firms will require classification under the CAD as set out in the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU) in the FSA handbook. The FSA decision trees for assessing capital adequacy classification can be found at the following link: http://www.fsa.gov.uk/pages/About/What/International/basel/pdf/crd_decisiontrees.pdf.

Exemptions

1. MiFID

Under **Article 2 of MiFID**, the directive (ie MiFID) will not apply to the below as long as they only undertake the below business in the UK. This exemption is commonly used by Collective Investment Scheme Managers including Venture Capital Trust Managers;

- persons which provide investment services exclusively for their parent undertakings, for their subsidiaries or for other subsidiaries of their parent undertakings;
- persons providing an investment service where that service is provided in an incidental manner in the course of a professional activity and that activity is regulated by legal or regulatory provisions or a code of ethics governing the profession which do not exclude the provision of that service;
- persons who do not provide any investment services or activities other than dealing on own account unless they are market makers 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;
- persons which provide investment services consisting exclusively in the administration of employee-participation schemes;
- persons which provide investment services which only involve both administration of employee-participation schemes and the provision of investment services exclusively for their parent undertakings, for their subsidiaries or for other subsidiaries of their parent undertakings;

- Compliance
- Internal Audit
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- the members of the European System of Central Banks and other national bodies performing similar functions and other public bodies charged with or intervening in the management of the public debt;
- collective investment undertakings and pension funds whether coordinated at Community level or not and the depositaries and managers of such undertakings;
- persons dealing on own account in financial instruments, or providing investment services in commodity derivatives or derivative contracts included in Annex I, Section C 10 to the clients of their main business, provided this is an ancillary activity to their main business, when considered on a group basis, and that main business is not the provision of investment services within the meaning of this Directive or banking services under Directive 2000/12/EC;
- persons providing investment advice in the course of providing another professional activity not covered by this Directive provided that the provision of such advice is not specifically remunerated;
- persons whose main business consists of dealing on own account in commodities and/or commodity derivatives. This exception shall not apply where the persons that deal on own account in commodities and/or commodity derivatives are part of a group the main business of which is the provision of other investment services within the meaning of this Directive or banking services under Directive 2000/12/EC;
- firms which provide investment services and/or perform investment activities consisting exclusively in dealing on own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets or which deal for the accounts of other members of those markets or make prices for them and which are guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such firms is assumed by clearing members of the same markets;

Under **Article 3 of MiFID**, a firm may be exempt if;

- It does not hold clients' funds or securities;
- It does 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;
- It transmits 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. 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.¹

Additionally, you are unable to take advantage of this exemption if you ‘place MiFID financial instruments without a firm commitment basis’²

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. When there is no such commitment, then you are placing without a ‘firm commitment basis’³.

2. CAD

You could be exempt from CAD and so be an ‘**exempt CAD firm**’ if you meet the following conditions:

- (1) you would have been a CAD investment firm if exempt CAD firms were not excluded from the definition; and
- (2) you are only authorised to provide the service of investment advice and/or receive and transmit orders from investors without in both cases holding money or securities belonging to its clients and which for that reason may not at any time place itself in debit with its clients.⁴

Please note however that:

- a) the permissions of investment advice and/or receive and transmit orders from investors do not exactly equate to FSA regulated activities. This means that as above firms who ‘place MiFID financial instruments without a firm commitment basis’ will be unable to make use of this exemption. However a firm is allowed to undertake other regulated business as long as it not on a regular basis, this has not been well defined by FSA however this may equate to roughly only once a year. So for example a firm may be able to undertake placing services on a non-regular basis.
- b) Where you hold client money for purposes unconnected with providing investment advice or receiving and transmitting orders in relation to MiFID financial instruments, 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.⁵
- c) If you are an investment firm to which an exemption in either article 2 or article 3 MiFID applies, 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

¹ PERG 13.5 Question 49 <http://fsahandbook.info/FSA/html/handbook/PERG/13/5>

² PERG 13.5 Question 50 <http://fsahandbook.info/FSA/html/handbook/PERG/13/5>

³ PERG 13.3 Question 22 <http://fsahandbook.info/FSA/html/handbook/PERG/13/3>

⁴ BIPRU 1.1.16 R <http://fsahandbook.info/FSA/html/handbook/BIPRU/1/1>

⁵ PERG 13.6 Question 58 <http://fsahandbook.info/FSA/html/handbook/PERG/13/6>

passporting rights you are subject to the recast CAD. If you do so, you are an exempt CAD firm.⁶

In order to become CAD exempt, you must add a requirement to your Scope of Permissions using a Variation of Permission notice to FSA so that the only MiFID investment services and activities you can perform are reception and transmission of orders or investment advice or both.

Benefits of exemption

If you are exempt from either MiFID or CAD, then you will have less of a regulatory burden and possibly a lower capital adequacy requirement.

⁶ PERG 13.6 Question 55 <http://fsahandbook.info/FSA/html/handbook/PERG/13/6>