

## BRIEFING NOTE – June 2007

### UK Implementation of the Markets in Financial Instruments Directive (MiFID): Impact on share plan administrators

#### 1. Background

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- 1.1 The Markets in Financial Instruments Directive (MiFID) is an overhaul of the existing legislation covering the provision of investment services within the European Union, namely the Investment Services Directive (ISD). MiFID is due to come into effect across the EU's 27 member states from 1 November 2007.
- 1.2 In light of the broad reforms contained within MiFID, this briefing note focuses on the narrow issue of the extent to which UK regulation currently affects employee share plan administration and the impact of MiFID on the scope of UK regulation after 1 November 2007.

#### 2. The current UK regulatory approach

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- 2.1 Current domestic regulation allows share plan administration a *partial* exemption from regulation under the Financial Services and Markets Act 2000 (FSMA). Under Article 71 of the Regulated Activities Order (RAO), administrators providing administration services *within their group* or *where they act as trustee* are exempted from regulation. Third-party administrators not acting as trustee do not satisfy the exemption and are therefore subject to FSMA regulation.
- 2.2 Although Article 71 RAO predates the ISD, it is not subject to the 'ISD override'. This means that Article 71 RAO takes precedence over the exemptions contained in the ISD when determining whether or not a firm is undertaking a regulated activity.
- 2.3 See *Appendix A* for the full text of Article 71 RAO.
- 2.4 While Article 71 RAO provides the main exemption, firms should consider that other exemptions under the RAO may apply. For example, Article 29 RAO exempts deals arranged with or through authorised persons in certain circumstances.

#### 3. MiFID: The impact on domestic UK regulation

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- 3.1 *ifs ProShare* has sought clarification from the EU Commission, the UK Treasury and the FSA as to the likely impact of MiFID. The following paragraphs provide a summary of the issue and how the UK has sought to solve it.

- 3.2 In implementing the MiFID directive, the UK Treasury was faced with the decision of bringing Article 71 RAO into line with EU legislation, or maintaining the status quo within existing domestic legislation.
- 3.3 The Treasury consultation paper – UK Implementation of MiFID, December 2005 – makes clear in Paragraph 3.31 that the employee share scheme exemption in MiFID Article 2(1)(e) is narrower than the exemption in Article 71 RAO because the MiFID exemption is ‘cast in an exclusive fashion’ – i.e. firms falling within it can only be providing such services within their group to satisfy the exemption - whereas Article 71 RAO also exempts services provided on a third-party basis by trustees.
- 3.4 HM Treasury argued that this position could be rectified either by applying the MiFID “override” to Article 71 RAO or by modifying the substance of Article 71 RAO to bring the scope of domestic regulation more into line with the EU. Either approach would have had the effect of narrowing the scope of the UK’s exemption and would, as a consequence, have widened the scope of UK regulation.
- 3.5 As a result of consultation, in which *ifs ProShare* submitted comments in favour of the status quo, the Treasury took the decision not to apply the MiFID override to Article 71 RAO. It also took the decision not to redraft Article 71 RAO in order to align its scope more evenly with that of MiFID. In essence, this means that the scope of UK domestic regulation will remain unchanged as a result of the UK’s implementation of MiFID after 1 November 2007.

#### 4. The post-MiFID regulatory position

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- 4.1 Following the UK’s approach to MiFID implementation, Article 71 RAO remains the ‘gateway’ to determine whether or not an administrator should be regulated, outlining what conditions an administrator must satisfy in order to exempt themselves from the requirements of FSMA (referred to in paragraph 2.1 above).
- 4.2 Broadly, anyone undertaking share plan administration within their own group or when acting as trustee on a third-party basis, can potentially be exempt from regulation. Where administration is taking place on a third-party basis, by way of business, then this would be considered a regulated activity and any administrator in this position would be required to seek FSA authorisation under Part IV of FSMA.
- 4.3 The FSA’s Perimeter Guidance Manual (PERG) contains guidance on activities which are regulated under FSMA and the available exemptions. The relevant guidance for firms is provided under chapter 2 (PERG 2) - see the link in 5.2.1 below.

#### 5. Determining whether administrators should seek FSA authorisation

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- 5.1 As a result of the decision not to apply the MiFID override to Article 71 RAO, the FSA has clarified in discussion with *ifs ProShare* that those administrators who currently rely on Article 71 RAO as the basis for their exemption from FSMA can continue to do so after 1 November 2007 without reference to MiFID. The process firms need to go through in order to identify whether or not they are regulated is illustrated below.
- 5.2 In determining whether an administrator should be regulated the following set of tests applies:

### 5.2.1 *Is the firm subject to regulation under the RAO?*

This involves considering whether it is carrying out regulated activities, by way of business, to which an RAO exemption does not apply. A firm need only consider whether it is subject to MiFID insofar as it is relying upon an RAO exemption to which the MiFID override applies.

Article 71 RAO is *not* subject to the MiFID override (therefore firms should refer to Perimeter Guidance Chapter 2). For more information click on the following link: [www.fsahandbook.info/FSA/html/handbook/PERG/2](http://fsahandbook.info/FSA/html/handbook/PERG/2)

Article 29 RAO *is* subject to the MiFID override (therefore firms should refer to Perimeter Guidance Chapter 13). For more information click on the following link: <http://fsahandbook.info/FSA/html/handbook/PERG/13>

5.2.2 *If a firm does not satisfy any exemptions, the firm should be FSA authorised (provided it is not an appointed representative)*

5.2.3 *If a firm is authorised by the FSA, it also needs to establish if it qualifies as a MiFID investment firm and therefore also subject to MiFID-based requirements*

In considering whether it is a MiFID investment firm, it should consider whether it can rely on any of the MiFID exemptions. It will qualify as a MiFID investment firm if it cannot satisfy the exemptions available under MiFID, which are set out below.

### **MIFID exemptions - Article 2**

The Directive shall not apply to:

Article 2.1(e) “persons which provide investment services consisting exclusively in the administration of employee participation schemes”

Article 2.1(f) “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”

The FSA has indicated that the exemption under Article 2.1(e) can also be combined with the ‘group exemption’ in Article 2.1(b) by virtue of Article 2.1(f) above, which covers activities within a group. The FSA has also highlighted Article 2.1(i) as being relevant if a firm is dealing on its 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.

Click on the following link for a copy of the MiFID Directive:

[http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l\\_145/l\\_14520040430en00010044.pdf](http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_145/l_14520040430en00010044.pdf)

If you have any queries please send them to [fdownes@ifslearning.com](mailto:fdownes@ifslearning.com); we will liaise with the FSA for clarification if necessary and summarise the results of any queries in a subsequent briefing note.

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## Appendix A

### Article 71: Activities carried on in connection with employee share schemes

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71. - (1) A person ("C"), a member of the same group as C or a relevant trustee does not carry on an activity of the kind specified by article 14 by entering as principal into a transaction the purpose of which is to enable or facilitate –

(a) transactions in shares in, or debentures issued by, C between, or for the benefit of, any of the persons mentioned in paragraph (2); or

(b) the holding of such shares or debentures by, or for the benefit of, such persons.

(2) The persons referred to in paragraph (1) are -

(a) the bona fide employees or former employees of C or of another member of the same group as C;

(b) the wives, husbands, widows, widowers, or children or step-children under the age of eighteen of such employees or former employees.

(3) C, a member of the same group as C or a relevant trustee does not carry on an activity of the kind specified by article 21 by entering as agent into a transaction of the kind described in paragraph (1).

(4) There are excluded from article 25(1) or (2) arrangements made by C, a member of the same group as C or a relevant trustee if the arrangements in question are for, or with a view to, a transaction of the kind described in paragraph (1).

(5) There is excluded from article 40 any activity if the assets in question are, or are to be, safeguarded and administered by C, a member of the same group as C or a relevant trustee for the purpose of enabling or facilitating transactions of the kind described in paragraph (1).

(6) In this article -

(a) "shares" and "debentures" include -

(i) any investment of the kind specified by article 76 or 77;

(ii) any investment of the kind specified by article 79 or 80 so far as relevant to articles 76 and 77; and

(iii) any investment of the kind specified by article 89 so far as relevant to investments of the kind mentioned in paragraph (i) or (ii);

(b) "relevant trustee" means a person who, in pursuance of the arrangements made for the purpose mentioned in paragraph (1), holds, as trustee, shares in or debentures issued by C.

Click on the following link to view full Regulated Activities Order:

<http://www.opsi.gov.uk/si/si2001/20010544.htm>