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COB REGIME

NON-MiFID DEFERRED MATTERS AND TELEPHONE RECORDING

The FSA has published a Consultation Paper (CP) setting out its proposals for reforming the remaining elements of the Conduct of Business (COB) Sourcebook that are outside the scope of the Markets in Financial Instruments Directive (MiFID) and which were not included in CP 06/19 or CP 06/20.

The CP (entitled "Conduct of Business regime: Non-MiFID deferred matters (including proposals for Telephone Recording), CP 07/09"), published on 3rd May 2007, also re-consults on some issues of client categorisation and financial promotions, where the FSA is revising some of the mainly non-MiFID proposals consulted on in CPs 06/19 and 06/20 respectively.

There are also proposals to introduce a telephone recording requirement that could apply to both MiFID and non-MiFID firms and small changes to the Client Assets sourcebook. The proposed rules on telephone recording will require firms to record telephone and electronic conversations across the equity, bond and financial and commodity derivatives markets where a firm receives client orders, where they involve the firm committing to deal as agent or principal, or where they relate to institutional sales.

The CP is linked to the overhaul of the Conduct of Business (COB) rules proposed in a sister consultation (CP 06/19 – see http://www.graingerconsult.com/topics/index.shtml.) It has been issued to cover non MiFID issues because the scope of MiFID is narrower than the scope of designated investment business for which the FSA has responsibility under the Financial Services and Markets Act 2000. As a result, there are a number of areas of business covered by the COB sourcebook which are outside the scope of MiFID

1. INTRODUCTION AND OVERVIEW - WHAT THIS IS ABOUT

Aspects of this CP will be of general interest to all firms covered by COB. There are general proposals covering:

- Best execution, order handling, client limit orders and client order record keeping;
- Client categorisation;
- Non-MiFID projections and charges information for packaged products;
- Financial promotions; and
- Telephone recording – recording of voice conversations and electronic communications.

There are also specific proposals covering various specialist regimes including:

- Corporate Finance;
- Commodity and Exotic Derivatives;
- Non-Financial Spread Betting;
- Service Companies;
- Depositaries;
- Lloyd's;
- Collective Investment Scheme (CIS) operators;
- Occupational Pension Scheme (OPS) firms;
- Authorised Professional Firms (APFs) carrying on non-mainstream regulated activities;
- UCITS Qualifiers; and
- Investment Companies with Variable Capital (ICVCs) otherwise known as Open Ended Investment Companies or OEICs.

The proposals continue the move towards Principles Based Regulation (PBR), and the introduction of NEWCOB. The paper uses the term "NEWCOB" to make a distinction between the proposed new

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sourcebook regime and the existing COB. When the proposals are made into Handbook text, the new sourcebook will be known as COBS.

1.1 Principles-based regulation

The change from prescriptive rules and regulations towards high-level provisions that focus on results rather than processes, with the minimum necessary prescription, is known as principles-based regulation (PBR). The FSA intends to focus more on management's responsibility for delivering the right outcomes for consumers and giving management more flexibility in the processes used to deliver this outcome.

PBR is intended to permit firms to exercise more discretion and flexibility, but place responsibility for oversight clearly on the senior management of firms. The changes are intended to allow firms to interpret and tailor the standards to meet the needs of the firm and any consumers to whom they are directed.

1.2 Implementation Issues

The overall aim is to establish NEWCOB by 1st November 2007. The FSA plans to apply MiFID requirements to non-MiFID firms and business only where this is appropriate. Where the NEWCOB requirements do not result directly from MiFID, there is additional flexibility and the FSA is planning to take this into account in the transitional arrangements.

2. THE KEY POINTS - GENERAL PROPOSALS

These proposals cover the areas where the scope of MiFID is narrower than existing COB. There will be a general application of MiFID provisions on best execution, order handling, client limit orders and client order record keeping. However, additional flexibility is proposed for some non-MiFID firms. The MiFID requirements on investment research will be applied to firms outside the scope of the Directive that produce such research, and the proposals for client categorisation are to use MiFID terminology for wholesale non-MiFID business but with appropriate modifications of definitions and grandfathering.

The proposals re-open certain issues discussed in CP06/19 in relation to non-MiFID firms and business.

The FSA has also put forward more proposals covering the rules on projections and charges for non-MiFID packaged product business and a number of minor changes to the financial promotions rules covering promotions of unregulated collective investments, some exemptions available to authorised professional firms and a transitional provision for non-MiFID financial promotions with a long shelf life.

2.1 Best Execution, Order Handling, Client Limit Orders and Client Order Record Keeping

The proposal is to apply the best execution and client order handling rules to cover non-MiFID firms and business where this business involves the execution of orders, placing client orders for execution as part of portfolio management or the transmission of orders to other entities for execution.

The orders covered relate only to MiFID financial instruments and therefore, as now, will not include life policies.

This proposal will mainly affect financial advisers, who receive and transmit client orders. Financial advisers are, in most but not all cases, exempted from MiFID by Article 3 of the Directive, which is being exercised in the UK. The exemption applies for firms who do not hold client funds or securities; only receive and transmit orders and/or provide investment advice in relation to transferable securities and units in collective investment undertakings; and only transmit orders to a limited range of other firms.

The MiFID NEWCOB standard for best execution by those receiving and transmitting orders (RTOs) is worded differently to the existing COB standard but the requirements of the two are broadly similar. MiFID requires an RTO to implement a policy for taking all reasonable steps to obtain the best possible result for the client. That policy must include firms to which the RTO passes its orders that allow the RTO to obtain the best possible result for the execution of its client orders. The current COB regime also requires an RTO to consider whether an entity to which it transmits orders for execution will allow it to obtain the best possible price for those orders.

The FSA says that the main reason for proposing change is that the MiFID standard offers a clearer description of a firm's responsibilities. In particular it makes more explicit a firm's responsibilities for monitoring and review.

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2.2 Client Categorisation

The proposals cover non-MiFID non-retail business, and follow proposals in CP 06/19 covering the other aspects of client categorisation (covering retail non-MiFID business and adopting the MiFID terminology of "retail client", "professional client" and "eligible counterparty"). CP 06/19 suggested that the FSA would be considering a number of issues including the boundary between professional clients and eligible counterparties in this paper.

One of the proposals put forward for retail non-MiFID business in CP 06/19 was to adopt MiFID categorisation terminology in a modified manner, and permit the use of grandfathering, where appropriate. The FSA says that this approach has been generally welcomed in the feedback to CP 06/19 and its proposals in this CP for non-MiFID non-retail business have been developed on this basis. The FSA is now discussing with HM Treasury the means by which it might grandfather firms' permissions and provide non-MiFID firms with appropriate transitional arrangements. Detailed proposals will therefore be put forward very shortly on this aspect, probably by way of a supplementary consultation.

2.2.1 Categorisation of per se and elective professional clients

The FSA is re-opening the consultation on some of the issues consulted on in CP 06/19, as these affect retail non-MiFID business. This includes whether the existing COB size criteria for the treatment of large undertakings as per se (automatic) professionals, and the assessment of such undertakings on a group rather than a company basis should be retained.

The FSA is proposing that the existing quantitative test should not generally be applied beyond MiFID business and equivalent business of a third-country investment firm. It says that although the MiFID qualitative test is very similar to existing COB requirements, the quantitative test establishes a much higher threshold for a client to be treated as an elective professional client, and some criteria are not relevant in certain industry sectors such as corporate finance, venture capital, Lloyd's business, OPS schemes etc.

The borderline between retail client and professional client for non-MiFID business has wider implications in relation to the categorisation of elective eligible counterparties because the MiFID categories of per se professional client and elective professional client form the basis on which firms are able to treat those clients as eligible counterparties. The decision to apply MiFID standards to non-MiFID business would limit the number of non-MiFID firms who could be treated as eligible counterparties.

2.2.2 Monetary criteria for the treatment of "large undertakings" as per se professional clients

To be treated as an elective eligible counterparty under MiFID, an undertaking must meet two of the following size criteria on a company basis:

- a balance sheet total of EUR 20m;
- net turnover of EUR 40m; or
- own funds of EUR 2m.

The FSA is proposing to retain the existing quantitative criteria for non MiFID business, for large undertakings who are per se professionals. It also proposes to allow those persons who meet the criteria to be treated as an eligible counterparty. This is because the COB criteria for body corporates are lower and less restrictive than under MiFID, and applying the MiFID criteria to non-MiFID business would mean more clients would need to be categorised as retail.

2.2.3 Application of MiFID large undertaking criteria on a "company basis" to non-MiFID business

The FSA is re-consulting on this issue, as a result of feedback. The MiFID size criteria for persons to be categorised as professional clients are similar to the criteria in COB. However, MiFID requires that undertakings who are prospective clients are assessed on an individual entity or "company basis", rather than on a group basis as permitted under the current COB rules. The implications are that undertakings which are part of a larger group would have to meet the size criteria in their own right rather than being able to rely on the size of their holding company or subsidiaries.

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The FSA is re-consulting to propose that clients should be assessed on a "group basis" for all non-MiFID business. This will thus involve two separate tests – one for MIFID and one for non-MiFID business.

2.2.4 Elective eligible counterparties

The FSA is proposing to adopt the MiFID Article 24(1) definition of "eligible counterparty business" in relation to both MiFID and non-MiFID business. This is because firms would find it difficult to distinguish between their MiFID and non-MiFID eligible counterparties. Certain COBS rules will be disapplied for eligible counterparty business in the appendix to COBS to cover non-MiFID business as well.

The MiFID Article 24 provisions are broadly similar to the current UK regime for market counterparties under the inter-professional business (IPB) regime in COB, except the IPB regime extends to regulated activities that constitute 'inter-professional business' including transaction specific advice. It excludes corporate finance business and activities carried on between operators of collective investment schemes.

2.2.5 General notification of client categorisation in relation to non-scope business

The proposal is that firms should be required to notify their non-MiFID retail and professional clients of their categorisation, which represents no change from the current COB regime. There would also be no change for eligible counterparties because most firms do not distinguish between those who are defined as such in the Glossary, and those who are can be treated as such because they are large undertakings under COB.

The notification requirement will apply to new clients only, and not to those who are clients of the firm prior to 1st November 2007.

2.2.6 Transitional provision

The FSA has added a transitional provision to enable non-MiFID firms to use the rules in force at 31st October 2007 for the period until 30th June 2008; to categorise intermediate customers and counterparties.

2.3 Investment Research

MiFID views investment research as an ancillary service. Where a firm is in-scope, producing investment research will be MiFID activity. However, there are several types of firms that could produce investment research which will not be covered by MiFID. These are:

- a CRD-only credit institution (ie one that does not offer investment services);
- a UK branch of a non-EEA credit institution investment firm;
- an independent research house which is an authorised person.

The FSA is proposing to apply the NEWCOB MiFID standard for investment research to non-MiFID firms if they produce investment research. This is because any firm which currently prepares investment research for publication or distribution to clients is currently subject to COB 7.16. This section sets out how firms should seek to manage conflicts, particularly where this research is held out to be impartial.

2.4 Non-MiFID Projections and Charges Information for Packaged Products

These proposals cover the simplification of the non-MiFID projections regime and the provision of charges information for packaged products which were excluded from other financial promotions proposals covered in CP 06/19. The near final rules are included in NEWCOB chapters 14 and 15, (included as an appendix to the CP) as the current provisions are contained in Chapter 6 of COB.

2.4.1 Non-MiFID Projections

The proposals follow the principles-based regulation (PBR) approach by simplifying the rules. The changes will not materially alter the overall structure of the regime, but will provide the opportunity for firms to provide this information to their target audience more appropriately. Simplifications include:

- Allowing greater use of generic – rather than personalised – projections, but only where the circumstances of the individual do not affect the premium or potential return;

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- Making the use of projections voluntary where they do not add value or context to the overall disclosure material (e.g. where the product is used as a pure investment vehicle rather than pension product or one purchased for life benefits);
- Requiring real projections to be provided at the point of sale for pensions.

The current requirements, which are linked to particular product types, will be amended so that the new simplified regime will include a high level requirement that firms should produce and provide personalised projections where these are relevant to the context of a sale. Additional guidance will be available to help in identifying the types of sales where it may not be necessary to provide a projection or, where one should be provided but personalised information may not be required.

There will therefore be three elements:

- A general requirement that a "key features" illustration be produced which includes information about charges and a projection (which may or may not be a mandatory inclusion);
- A requirement that it is sufficiently relevant to the client (i.e. do the circumstances of the sale make a personalised projection necessary); and
- Detailed requirements as to how to calculate the projection, and some requirements over its presentation and messages which should accompany it.

The illustration may be incorporated into the key features document, but if used separately as a stand-alone document, then it will have to include a keyfacts logo and a regulatory message. Additional projections for life and pensions packaged products are to be permitted, so long as these do not detract from the standardised projection within the key features illustration.

If generic information on pensions products is used, it should contain a range of different premium levels and terms to retirement and retirement ages, to enable clients to apply the information to their own circumstances.

The FSA is also proposing to bring into force its plans, originally proposed in CP134 (Pension Projections, April 2002), to require firms to use inflation-adjusted projections for pension products. The original proposals were delayed because of concerns over the timing, but the FSA is now to make mandatory the existing voluntary requirements. This will require firms to include, at the very least, an additional figure showing pension benefits in real terms, assuming the intermediate growth rate. For generic pension projections a range of figures will be supplied to include figures in real terms (as with the stakeholder pension projection table).

The projection rates will be reviewed during 2007 and if any changes are required these will be implemented within the transitional arrangements for the overall regime.

2.4.2 <u>Charges Information for Packaged Products</u>

The existing Effect of Charges and Reduction in Yield (RIY) requirements are intended to ensure that information is provided on a consistent basis. These requirements will not change, and will continue to apply to both MiFID and non-MiFID business.

The European Commission is also currently carrying out a review of the effectiveness of the Simplified Prospectus (SP) requirements which apply to UCITS products. As this is likely to result in some changes which are likely to require the FSA to reconsider the read across to non-UCITS products, the FSA has decided not to amend its requirements at present.

However, the requirement to disclose the Reduction in Yield and Effect of Charges for SP products is subject to a 'sunset' clause that expires in 2009. The FSA will therefore be reviewing this during 2008 to establish if significant consumer protection reasons exist to justify the extension of its application beyond 2009.

The FSA will also bring within the scope of its Rules the existing Guidance provided by the actuarial profession in GN22, which cover the treatment of expenses.

A transitional period of 12 months from 31st October 2007 will apply for the old disclosure rules.

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2.5 Financial Promotions

There are some minor proposals not covered or revised since CP 06/20 (October 2006). These affect the promotion of unregulated collective investment schemes and exemptions available to authorised professional firms when communicating financial promotions.

2.5.1 Unregulated collective investment schemes

The proposals reflect the existing rules and guidance, and mean that the new test will be simplified and clarified. It will also use the new MiFID client categorisation nomenclature, but with non-MiFID meanings. Because of this, the borderline between those promotions which are and are not possible has moved slightly. The distinction between the new retail client and new professional client will determine the type of client a firm can, or cannot, market these products to. This replaces the existing "private customer/intermediate customer" boundary.

2.5.2 Exemptions available to authorised professional firms

The FSA is proposing to retain the exemption which applies financial promotions communications made by authorised professional firms where they relate to either the firm's professional services, or its non-mainstream regulated activities.

2.6 Telephone Recording

This is one area where Rules will replace previous Guidance. Currently, the Market Conduct Sourcebook (MAR) includes guidance on the circumstances in which firms might find it appropriate to maintain records of voice conversations. The FSA will also apply these rules more widely than is currently the case. The move is intended to address inside dealing, market manipulation, and assist the investigation of suspicious cases.

The CP proposes that firms will be required to record telephone lines used for voice conversations that involve the receipt of client orders and the negotiating, agreeing and arranging of transactions across the equity, bond and financial commodity and derivatives markets, and to retain electronic communications relevant to these activities.

The term electronic communications includes fax, e-mail, chat and instant messaging but is not limited to these.

Activities within the scope of the new proposals include proprietary trading and other principal dealing and agency broking and the associated sales functions. The range of instruments is wide but does not include insurance-based or collective investment scheme (CIS) products. It does however cover the (regulated) dealing activities of individuals managing such funds.

Individuals that will be affected are principal dealers and agency brokers (in respect of any type of client or counterparty) and the associated sales functions. A wide variety of firms will be affected, including banks, stockbrokers, investment managers generally (including CIS managers and hedge fund managers) and insurance companies will be affected. The CP says that those who will **not** be included on cost benefit grounds, are the activities of individuals who are investment managers but who do not have authority to deal; retail financial advisers; corporate finance advisers – unless they also carry on the relevant activities – and treasury and back office functions.

Firms are to be required to retain the records for three years from the date of creation.

Records are to be kept so that:

- they are accessible for future reference;
- any corrections or other amendments must be easily identifiable;
- the contents of the records prior to such corrections or amendments, must be easily ascertained; and
- it is not possible for the records otherwise to be manipulated or altered.

This is in accordance with the MiFID general record-keeping standard.

The FSA is not proposing to impose a standard that goes beyond current commercial practice, and notes that unless there is reason to suppose employees might set out to falsify their e-mail records, the establishment of more elaborate anti-tampering measures should not be necessary. It also says

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that firms will not be prevented from recording conversations more widely, and that the proposals do not relieve them from other specific and general record-keeping requirements.

3. KEY POINTS AND IMPLICATIONS – SPECIALIST REGIMES

Generally, the proposals mean that the modifications for specialist regimes will be carried forward with little change. However, the FSA wants to modify them by updating the exemptions and modifications in line with NEWCOB and MiFID terminology, and also by removing some unnecessary rules in the interests of moving to PBR. This includes a deletion of most of the rules which apply to designated investment business in the Lloyd's market.

3.1 Corporate Finance Firms

At present, corporate finance firms are subject to various concessions (COB 1.6), so that the main COB provisions which apply are those covering inducements, suitability, conflicts, customers' understanding of risk, information about the firm, customer order and execution records and personal account dealing.

The proposal is to broadly retain the concessionary approach, so many of the NEWCOB provisions will not apply. These will include provisions covering customers' understanding of risk, information about the firm, suitability, personal account dealing and customer order and execution records.

Where the NEWCOB rules will apply, these will be the equivalents of the existing COB rules which apply to these firms.

The effect will be to create a NEWCOB regime for firms outside the scope of MiFID who undertake corporate finance business that is not the same as that for firms inside the scope of MiFID.

Most firms undertaking corporate finance business are inside the scope of MiFID. However, some firms undertaking such business will be non-MiFID firms because, for example, they fall Article 2 (professional firms who carry on an investment service which is incidental to a professional activity) or Article 3 (firms who only provide investment advice) exemptions. Whilst the Article 3 exception can also apply to firms who receive and transmit as well as providing investment advice, a firm who may receive and transmit as part of its corporate finance business will generally be transmitting orders to firms falling outside the category of permitted persons for the purposes of the Article 3 exception. Therefore, the Article 3 exception will generally only be relevant for corporate finance firms who just provide investment advice.

3.2 Commodity and Exotic Derivatives

The proposals substantially maintain the existing standards and the impact on firms will be minor.

MiFID extends the scope of EU regulation to activities relating to commodity and 'exotic' derivatives (derivatives based on underlyings such as emission allowances, climatic variables and telecommunications bandwidth). MiFID does not cover all firms undertaking these activities, or all commodity derivatives caught by existing UK regulation. The UK regulations do not have the same broad exemptions as those in MiFID, and UK legislation covers a much wider range of options on precious metals and commodity futures.

The current concessionary regime in COB 1.6 applies to firms undertaking energy and oil market activity. It disapplies provisions on inducements, advising and selling, product disclosure and best execution. It applies financial promotion, client classification, conflicts, dealing ahead and investment research provisions.

For commodity or exotic derivatives business outside the scope of MiFID the policy approach is to be retained as in existing COB. This means that the concessionary regime for oil and energy market activities will be retained. For other regulated commodity derivatives and exotic derivatives business, the only NEWCOB provisions which will apply are those which are substantially the same as the current COB provisions. For example, provisions in NEWCOB, such as suitability requirements for professional clients, will not apply because they only apply to MiFID business. One specific modification is to retain the existing COB best execution rule rather than apply the NEWCOB MiFID standard (other than for oil and energy activity where the existing disapplication of best execution will be maintained).

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3.3 Non-Financial Spread Betting

MiFID views spread-betting transactions on shares and other financial instruments and indices as "financial contracts for differences". Most other spread-betting transactions, such as spread bets on sports, political or leisure events are outside the scope of the Directive. However, such transactions are inside the scope of UK financial services legislation.

They are currently offered by a small number of regulated firms most of which also offer MiFID spread-betting products.

COB applies to non-financial spread betting as it applies to execution-only transactions of other contracts for differences. However, firms have waivers from best execution in executing orders for these instruments. The waivers prevent firms from giving investment advice in relation to these transactions.

The FSA is proposing to disapply the best execution requirement for non-financial spread betting when firms do not give investment advice on these transactions. The new rule will apply from 1st November 2007, as most existing waivers are due to expire in the course of November.

Certain NEWCOB rules (for example suitability requirements) are not relevant for non-financial spread bets as these sales are non-advised and at the instructions of the client. Some NEWCOB rules will be modified or will provide flexibilities for non-MiFID business. There are some other small changes which firms should be aware of, namely the proposal to delete the product specific risk warnings from COB and instead rely on the MiFID high level standards when preparing risk warnings; the proposal to retain existing COB flexibilities for reporting to non-MiFID retail clients and the proposals in relation to the appropriateness test set out in CP 06/20.

3.4 Service Companies

These are firms whose only permitted activities are making arrangements with a view to transactions in investments, and agreeing to carry on that regulated activity. They are mainly technology companies who provide market professionals with trade support services. They are outside the scope of MiFID as they do not provide MiFID investment services nor do they engage in MiFID activities.

The only provisions in COB which apply are those relating to financial promotion and investment research. The FSA is proposing to maintain the existing approach by applying only the NEWCOB rules which are equivalent to the COB rules which currently apply.

3.5 Depositaries

Depositaries of collective investment schemes are those persons to whom the property of a scheme is entrusted for safekeeping; they include trustees of authorised unit trust schemes in the UK. There are only eight authorised persons acting as depositaries in the UK. Depositaries are exempt from MiFID under Article 2

COB 11 applies a concessionary regime to depositaries so that the main rules which apply to them include inducements, financial promotion, information about the firm, conflicts of interest, Chinese walls and personal account dealing. The FSA will carry forward the existing provisions into NEWCOB. There will be some modifications to bring these up to MiFID standards but also to disapply some requirements.

- Inducements – the MiFID rules will be applied, as modified for non-MiFID retail firms and business.
- Financial promotions – the NEWCOB standard will be applied. This will effectively exempt promotions made to other authorised persons.
- Information about the firm – rules will be replaced with a general reliance on Principle 7 (Communications with clients).
- Personal account dealing – the MiFID standard will apply which is similar to the COB standard.

3.6 Lloyd's

The principles based approach means that the FSA is proposing to remove many rules which currently apply to Lloyds firms in COB12.

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There will be guidance to remind firms carrying out the activities currently covered by COB 12 (which will be defined in the Handbook glossary as "Lloyd's market activities") that the Principles will continue to apply to those activities.

The financial promotion rules will still apply to firms carrying on Lloyd's market activities, but in practice, the FSA says that much of this will be exempt as the NEWCOB rules provide an exemption to recipients who the firm reasonably believes are eligible counterparties or professional clients.

Lloyd's firms behaviour will continue to be subject to the Principles, as well as the Society's detailed byelaws, general code of conduct and agency agreements. Together these cover much the same ground as the existing COB regime.

However, the move to a reliance on the Principles in preference to detailed COB provisions will impact on actions for damages by private persons (including Lloyd's members). While a contravention of a rule in COB would give rise to a right of action under Section 150 of FSMA, a contravention of the Principles would not. However, the FSA does not expect this to have a significant effect on consumers because:

- Section 150 is hardly ever exercised;
- Lloyd's members enjoy protections under the Society's rules; and
- Members would still potentially have recourse to legal action for negligence under contract or agency law.

3.7 Collective Investment Scheme (CIS) operators

Collective Investment Scheme (CIS) operators are outside the scope of MiFID under the Article 2 exemption.

The CP proposals are to maintain the current concessionary treatment of CIS operators in COB 10 (including operators of private equity schemes) in NEWCOB. The terminology will be updated to reflect MiFID and some existing obligations are disapplied.

The FSA has proposed the removal of some rules that are no longer necessary. These include the suitability rule in COB 10.4 requiring an operator of an unregulated scheme to take investment management decisions which are suitable for the scheme. The order allocation rule in COB 10.3 will not be replaced in NEWCOB as the NEWCOB rule no longer specifies a time period for the allocation of orders beyond the high-level standard of "prompt". On best execution, it is proposed that CIS operators are subject to the MiFID-based rules but that the existing exemption in COB 10.5, which can be used by operators of unregulated schemes, be retained.

3.8 Occupational Pension Scheme (OPS) firms

These are firms whose primary activity is to undertake investment management on behalf of a group occupational pension scheme or welfare trust. Such firms are outside the scope of MiFID. Only 15 such firms are regulated in the UK.

Various modifications apply in COB to such firms which reflect the particular nature of the business carried out. The FSA is proposing to maintain the current COB approach by applying adjusted MiFID standards to OPS firms, and maintaining the current COB modifications for OPS firms in NEWCOB.

3.8.1 Impact of the MiFID client categorisation and best execution requirements

Although the FSA is proposing to maintain the existing modified COB regime in NEWCOB, there will be an important impact under the MiFID best execution and client categorisation requirements.

Under the existing COB client classification regime, trustees of OPS firms are generally treated as intermediate customers; if the trust does not meet certain specified criteria, the trustees will be treated as private customers. A firm may also classify an OPS firm which is an intermediate customer as a market counterparty in some cases. OPS firms may elect, with the consent of the executing firm, to be treated as a private or intermediate customer rather than as a market counterparty. There is an exception from the general best execution rule in COB for firms dealing with intermediate customers – allowing them to agree with those customers that best execution would not be provided. This exception is specifically removed for trustees of OPSs. Only OPS firms classified as market counterparties do not receive best execution from the firms

executing their decisions to deal. This rule is incompatible with the MiFID provisions covering 'per se' eligible counterparties. This means any OPS firm wishing to obtain best execution will have to request best execution if they want it – negotiating with firms to receive best execution (or the other COB protections that firms are not required to provide under MiFID) possibly by requesting treatment as a professional or retail client for these purposes. This could be achieved by agreeing with the firm that the OPS would be 'opted-down' to retail or professional client status in relation to these services.

OPS firms, as portfolio managers, are however required to provide best execution to their clients (i.e. the fund or welfare trust) under MiFID's best execution rules for portfolio managers. MiFID requires firms to take factors other than price into account to obtain the 'best possible result' for the execution of client orders. OPS firms would also be required to establish and implement a policy that enables them to meet the MiFID best execution standard, to monitor and review this policy, and to disclose appropriate information about it to their clients.

3.9 Authorised Professional Firms (APFs) carrying on non-mainstream regulated activities

These firms are subject to fewer COB requirements than those APFs carrying on mainstream regulated activities. They will still be subject to the professional standards set out by their relevant designated professional body, but much of COB is disapplied.

The FSA will carry forward most of the existing regime to NEWCOB (COBS 19.11), but some small changes are to be made:

- The COBS rule which includes the basic current requirement for all communications to be 'fair, clear and not misleading' is to apply.
- The current exemption from the financial promotion rules will continue in NEWCOB. Some unintended restrictions on the financial promotion of unregulated collective investment schemes that apply to APFs carrying on non-mainstream regulated activities (NMRAs) will be corrected.
- The FSA will disapply a new requirement for firms to disclose information about their services, including information on their conflicts of interest policy as this is covered in the relevant professional standards.
- APFs carrying on NMRAs will no longer be required to disclose in their client agreements details of their complaints processes and any compensation arrangements, which are also covered in the relevant professional standards.

These changes will come into effect on the planned implementation date for NEWCOB on 1st November 2007.

3.10 UCITS Qualifiers

UCITS Qualifiers are authorised persons who operate or act as the trustee or depositary of a UCITS fund established outside the UK and which is a recognised overseas Collective Investment Scheme (CIS) under section 264 of the Financial Services and Markets Act. They are exempt from MiFID under Article 2 of the Directive.

The FSA is proposing that there should be minimal changes with equivalent rules in NEWCOB to those which currently apply in COB. Firms may however need to review their approach to the communication and approval of financial promotions. This is because the COB sourcebook changes means that the E-commerce rules have been revised. The financial promotion rules are also changing as a result of the Financial Promotion Review and MiFID. The rules governing disclosures for investment research recommendations are unchanged.

3.11 Investment Companies with Variable Capital - Open Ended Investment Companies (OEICs)

Investment Companies with Variable Capital (ICVCs) are more generally known as Open Ended Investment Companies or OEICs). These are companies which are both authorised persons under FSMA and a form of collective investment scheme (CIS). They are exempt from MiFID under Article 2.

At present, COB does not apply to ICVCs, but the Conduct of Business sourcebook (MiFID Transposition) Instrument 2007, which takes effect on 1st November 2007, will bring them into the financial promotion rules. No change is proposed in this respect and the current exemption for ICVCs from COB regulation will continue.

4. WHAT IS GOING TO HAPPEN NEXT

The consultation period closes on 3rd August 2007. The new rules will be made in time to take effect on 1st November 2007 although there will be various transitional arrangements as described above.

5. WHERE TO GO FOR EXTRA DETAIL

The Consultation Paper is at the following link:
http://www.fsa.gov.uk/pages/Library/Policy/CP/2007/07_09.shtml

The Reforming COB CP can be found at http://www.fsa.gov.uk/pubs/cp/cp06_19.pdf and the Financial promotion and other communications CP can be found at
http://www.fsa.gov.uk/Pages/Library/Policy/CP/2006/06_20.shtml.

Additional bulletins from Grainger Consulting, on MiFID and other topics can be found at:
http://www.graingerconsult.com/topics/index.shtml

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