



Jersey Financial
Services Commission

Consultation Paper

No. 3 2016

› MiFID II – Consultation on whether to introduce an EU equivalent regime in Jersey

The introduction of MiFID II presents an opportunity for Jersey's Investment Businesses to participate in the EU passport for professional investors – subject to Jersey's investment business regime being judged as MiFID II equivalent. However, implementing a MiFID II equivalent regime is not without cost.

This consultation paper seeks to gather the opinions of stakeholders as to whether Jersey should seek equivalence. The paper describes at a high-level the regulatory changes that may be necessary for Jersey to demonstrate equivalence.

Issued: 25 April 2016

› Consultation Paper

The Commission invites comments on this consultation paper. **Thomas Cowsill** at Jersey Finance are co-ordinating an Industry response that will incorporate any matters raised by local businesses. Comments should reach Jersey Finance by **15 July 2016**.

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It is the policy of Jersey Finance (unless otherwise requested or agreed) to collate all responses received and share them verbatim with the JFSC on an anonymised basis (with reference made only to the type of respondent e.g. individual, law firm, bank, trust company etc.) This collated, anonymised response will, typically, be placed in JFL's permanent electronic archive which is currently open to all JFL members.

Alternatively, responses may be sent directly to **John Charles Cronin** at the Commission by **22 July 2016**. If you require any assistance, clarification or wish to discuss any aspect of the proposal prior to formulating a response, it is of course appropriate to contact the Commission.

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It is the policy of the Commission to make the content of all responses available for public inspection unless specifically requested otherwise.

› Glossary of terms

European Union and International Terms

AIFMD	Alternative Investment Fund Managers Directive (2011/61/EU)
CRD	Capital Requirements Directive (2013/36/EU)
CRD IV	Equals CRD + CRR (the regulatory package)
CRR	Capital Requirements Regulation ((EU) No 575/2013)
EBA	European Banking Authority
EMIR	European Markets Infrastructure Regulation ((EU) No 648/2012)
ESMA	European Securities and Markets Authority
EU	The European Union
FSCS	UK – Financial Services Compensation Scheme
G20	The international forum of the world’s twenty largest economies
ICSD	Investor Compensation Scheme Directive (97/9/EC)
MAD	Market Abuse Directive (2014/57/EU)
MAR	Market Abuse Regulation ((EU) No 596/2014)
MiFID	Markets in Financial Instruments Directive (2014/65/EU)
MiFID I	Markets in Financial Instruments Directive (2004/39/EU)
MiFID II	equals MiFID + MiFIR (the regulatory package)
MiFIR	Markets in Financial Instruments Regulation ((EU) No 600/2014)
MS	EU Member State
MTF	Multilateral Trading Facility
OTC	Over-the-Counter, a term linked with off-exchange securities transactions
OTF	Organised Trading Facility
third-country	means any jurisdiction outside the EU, including Jersey

Jersey Terms

ANLA	Adjusted Net Liquid Assets
Commission	The Jersey Financial Services Commission
Commission Law	Financial Services Commission (Jersey) Law 1998
CoP	The Commission's Codes of Practice, in general this consultation paper refers to the Codes of Practice for Investment Business. However, the scope of MiFID II may affect other Commission Codes of Practice.
FS(J)L	Financial Services (Jersey) Law 1998
FSC(FP)(S)O	Financial Services Commission (Financial Penalties) (Jersey) Order 2015
IB	Investment Business, see article 2(2) of the FS(J)L
Jersey Finance	Jersey Finance Limited
Registered Person	A person who is registered, or holds a permit or certificate, as applicable, under one or more of Jersey's regulatory laws. The regulatory laws are the Alternative Investment Funds Regulations, the Banking Business Jersey Law, the Collective Investment Funds Jersey Law, the Financial Services Jersey Law, the Insurance Business Jersey Law and the Proceeds of Crime (Supervisory Bodies) Jersey Law.

› Links to EU Legislative Texts

CRD	http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013L0036&from=EN
CRR	http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0575&from=EN
EMIR	http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32012R0648&from=EN
ICSD	http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31997L0009&from=EN
MAD	http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0057&from=EN
MAR	http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0596&from=EN
MiFID	http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0065&from=EN
MiFIR	http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0600&from=EN
MiFID II Delegated Directive	http://ec.europa.eu/finance/securities/docs/isd/mifid/160407-delegated-directive_en.pdf

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1 Executive Summary

1.1 Overview

- 1.1.1 The introduction of the second Markets in Financial Instruments Directive regulatory package (**MiFID II**) in the European Union (**EU**) aims to raise standards of investor protection and market transparency across Europe.
- 1.1.2 MiFID II could provide an opportunity for Registered Persons to passport their services to professional investors across the EU, without need for authorisation from EU Member States (**MSs**). However, this opportunity is contingent upon Jersey's financial services regime having been assessed as being equivalent to the MiFID II regulatory regime.
- 1.1.3 Developing and implementing MiFID II equivalence will be costly for the Commission, Government and Registered Persons. MiFID II may require authorisation for previously exempt activities.
- 1.1.4 Conversely, not achieving equivalence with MiFID II could present a threat to parts of Jersey's financial services sector. MiFID II equivalence provides a kite mark of recognition that Jersey's financial services regime is consistent with European standards and provides greater market access.
- 1.1.5 In view of the above the Commission invites stakeholders to comment on whether Jersey's financial services regime should, or should not, seek MiFID II equivalence. If it is decided that Jersey's financial services regime should seek MiFID II equivalence, then this will require changes in Jersey's financial services legislation and the *Commission's* Codes of Practice (**CoP**). The Commission envisages that changes in the CoP will mainly affect the CoP for Investment Business (**IB**). However, the scope of MiFID II equivalence requirements may lead to changes in other CoP.
- 1.1.6 The assessment of non-*EU* (**third-country**) jurisdictional equivalence will be conducted by the European Commission. The scope of this assessment also includes compliance with the regulatory goals and standards concerning derivatives, consistent with the G20 requirements. To comply with these requirements, the Commission includes within this consultation paper proposals to incorporate parts of the *EU's* European Markets Infrastructure Regulation (**EMIR**).
- 1.1.7 The publication of this consultation paper follows initial detailed stakeholder engagement with IB Registered Persons; who were generally supportive of Jersey's financial services regime becoming MiFID II equivalent. Details of the Commission's research and analysis with IB Registered Persons are set out in Appendices A and B of this paper.

1.2 Facilitating industry market access

- 1.2.1 Summarising the opportunities for Registered Persons in the EU, post the implementation of MiFID II, is difficult due to several unknowns, many of which relate to final standards that have neither been drafted or approved, either at an EU level or in each MS. One key unknown concerns third-country investment firm access to MSs. This decision resides with each MS, but is complicated by the following three factors.

Firstly, whether the MS elects to adopt the EU harmonised branch regime described in article 39 of MiFID; secondly, whether the third-country jurisdiction is granted regulatory

equivalence, as described in articles 46 and 47 of MiFIR; and lastly, the application of the transitional provision, set out in article 54 of MiFIR.

The MiFID article 39 EU harmonised branch

1.2.1.1 Currently access to retail and professional investors, for third-country investment firms, in a MS is subject to the requirements set by the individual MS. Registered Persons currently access the EU markets this way. MiFID introduces the option for MSs to apply an EU harmonised branch requirement on third-country investment firms, built on a set of common standards described in MiFID article 39, as an alternative to their national regimes. Currently in the UK, if a third-country firm decides not to establish an authorised subsidiary or branch within the UK, then access to UK clients is restricted to the UK's overseas persons regime¹ (effectively reverse solicitation) with limited exemptions for financial promotions to Self-certified High Net Worth and Sophisticated Investors². The Commission understands that the UK is currently not minded to adopt the article 39 EU harmonised branch – that is, Registered Persons could continue to access the UK market as they do currently. This does not require an equivalence decision. If the UK did decide to adopt the article 39 EU harmonised branch, third-country investment firms would only be able to solicit for business with retail and professional investors through a branch in the UK. Reverse solicitation remains as an option, but it is unclear whether the exemptions concerning financial promotions could continue if the UK opted into the article 39 EU harmonised branch regime or not. It is not currently clear how many MSs will adopt the article 39 EU harmonised branch requirement in their jurisdictions.

MiFID II equivalence

1.2.1.2 Currently third-country investment firms, without authorised subsidiaries within a MS, do not have access to the single market for MiFID investment services and activities. However under MiFID II, if the home jurisdiction of a third-country investment firm is judged as being equivalent, then following registration with ESMA that investment firm has the right to solicit per se professional investors (including large undertakings) across the EU without the need to have a physical authorised presence in the EU (the EU professional investor passport). If the third-country investment firm, of a MiFID II equivalent jurisdiction, is established in the EU through an article 39 EU harmonised branch within a MS, then it may solicit professional investors across the EU, without need to register with ESMA.

Transitional provision

1.2.1.3 A final feature to consider is the transitional provision described in MiFIR, article 54 states 'Third-country firms shall be able to continue to provide services and activities in Member States, in accordance with national regimes until three years after the adoption by the [European] Commission of a [equivalence] decision in relation to the relevant third country in accordance with Article 47'.

¹ Overseas persons – See article 72 of the Financial Services and Markets Act (Regulated Activities) Order

² Financial promotions exemptions – See Financial Services and Markets Act (Financial Promotion) Order

- 1.2.2 The table below summarises the options open to Registered Persons, if Jersey is recognised as MiFID II equivalent or continues with its current regime.

<p>Jersey with MiFID II equivalence</p>	<ul style="list-style-type: none"> › The right to solicit business with EU professional investors (including large undertakings) across the EU, via ESMA registration, without the need for an authorised physical presence in the EU; or › The right to solicit business with EU professional investors (including large undertakings) across the EU, from an article 39 EU harmonised branch. › Reverse solicitation continues as an option.
<p>Jersey maintains its current regime</p>	<ul style="list-style-type: none"> › No right to solicit business with EU professional investors (including large undertakings) across the EU. › Access to MS retail and professional investors is determined by individual MS national regimes; or › Access may be dependent on the article 39 EU harmonised branch requirements. › Reverse solicitation continues as an option.

1.3 What is proposed and why?

- 1.3.1 This consultation paper explores at a high-level the significant changes that may need to be made to Jersey’s financial services regime, if a MiFID II equivalent regime is introduced in Jersey. If Jersey chooses to adopt a MiFID II equivalent regime, it would be a regime that is proportionate to the services and activities that take place in the Island. For example because the Island does not have any trading venues, these parts of MiFID II would be switched ‘off’. This would avoid the need to introduce a detailed regulatory regime, and to commit supervisory resources to activities that do not occur in Jersey. It is proposed to have a facility to switch ‘on’ these activities by Ministerial Order, if they are required.
- 1.3.2 The consultation paper proposes that a Jersey MiFID II equivalent regime would apply to all clients, irrespective of EU residency. The rationale behind this is reduced complexity for both industry and the Commission from operating one regulatory regime, equal treatment of clients, and because, based on feedback received to date, it appears to be industry’s favoured option. In addition, the Commission understands that the European Commission may demand it as a condition of equivalence.

1.4 Who would be affected?

- 1.4.1 In broad terms MiFID II brings within its scope all persons involved in the dealing, reception and transmission of orders (including arranging transactions), advising, and portfolio management of MiFID defined financial instruments on behalf of clients, for commercial gain. In Jersey terms many of these persons are already within the scope of the FS(J)L.
- 1.4.2 Potentially there are **unregulated persons** that would be within the scope of MiFID II, and Registered Persons, that may need new or additional licences under FS(J)L.

- 1.4.3 All Registered Persons holding an **IB licence** are within the scope of MiFID II. However, within the IB licence group MiFID provides an optional exemption, with conditions, for Class D investment business, (Registered Persons who provide investment advice that do not hold client money or securities). The scope and limitations of this optional exemption are discussed later in sub-section 4.3 of this paper. Hence, all Registered Persons with an IB licence should read this consultation.
- 1.4.4 Registered Persons with **banking licences**, who manufacture and distribute financial products are also within the scope of MiFID II and this consultation.
- 1.4.5 There are several areas of financial services activity that may fall within the scope of a MiFID II equivalent regime, which will require further analysis by the Commission. These are signposted in the sub-paragraphs below.
- 1.4.5.1 The advisers, and distributors, of **public (CIF) and private (COBO) collective investment funds** could be within the scope of MiFID II and this consultation and may need an IB licence.
- 1.4.5.2 Managers of **public (CIF) and private (COBO) collective investment funds** and their depositaries are probably excluded from the scope of the MiFID. Under the EU regime these service providers are either within the scope of the Undertakings for Collective Investment in Transferable Securities (**UCITS**) Directive or Alternative Investment Fund Managers Directive (**AIFMD**).
- 1.4.5.3 The advisers and managers of **'investment schemes'**, distinct from collective investment funds, who are currently relying on an exemption from authorisation under FS(J)L are probably within the scope of the MiFID and this consultation. Hence, this paper is of interest to advisers and managers who make use of the three **exemption Orders** listed in the footnotes below^{3, 4 & 5}.
- 1.4.5.4 Registered Persons licensed for **Trust Company Business**, who undertake the safekeeping of MiFID financial instruments, see Annex 1, Section C of MiFID, may also be within the scope of MiFID II and this consultation.
- 1.4.6 MiFID states that exempt from its scope and therefore this consultation are, amongst others, all entities undertaking insurance business, persons providing investment services exclusively for themselves, or for parent undertakings, and those who provide investment services in an incidental manner in the course of a professional activity. Article 2 of MiFID provides a complete list of exempt activities.

³ Financial Services (Investment Business (Special Purpose Investment Business – Exemption)) (Jersey) Order 2001

⁴ Financial Services (Investment Business (Restricted Investment Business – Exemption)) (Jersey) Order 2001

⁵ Financial Services (Investment Business (Qualifying Segregated Managed Accounts – Exemption)) (Jersey) Order 2014

2 Consultation

2.1 Basis for consultation

- 2.1.1 The Commission has issued this consultation paper in accordance with Article 8(3) of the Financial Services Commission (Jersey) Law 1998 (the **Commission Law**), as amended, under which the Commission “*may, in connection with the carrying out of its functions -consult and seek the advice of such persons or bodies whether inside or outside Jersey as it considers appropriate*”.

2.2 Responding to the consultation

- 2.2.1 The Commission invites comments in writing from interested parties on the proposals included in this consultation paper. Where comments are made by an industry body or association, that body or association should also provide a summary of the type of individuals and/or institutions that it represents.
- 2.2.2 To assist in analysing responses to the consultation paper, respondents are strongly encouraged to respond by completing the response template, issued with this consultation. Please send your responses by email to j.cronin@jerseyfsc.org

2.3 Next steps

- 2.3.1 The Commission will publish a feedback statement on responses received to this consultation. If stakeholders are in support of a MiFID II equivalent regime, the Commission will adopt a twin track approach, consulting separately on proposed changes in the Law and CoP through 2016 and 2017. Subject to stakeholder support, the Commission aims to introduce its MiFID II equivalent regime in line with MiFID II’s effective date in the EU.
- 2.3.2 Readers will be aware that the European Commission has proposed postponing MiFID II’s 2017 entry into force by one year. The Commission welcomes this delay as it provides more time for Jersey to implement its own measures, if appropriate, and for industry to respond accordingly.

3 The Commission

3.1 Overview

- 3.1.1 The Commission is a statutory body corporate established under the Commission Law. It is responsible for the supervision and development of financial services provided in or from within Jersey.

3.2 Commission's functions

- 3.2.1 The Commission Law prescribes that the Commission shall be responsible for:
- 3.2.1.1 the supervision and development of financial services provided in or from within Jersey;
 - 3.2.1.2 providing the States, any Minister or any other public body with reports, advice, assistance and information in relation to any matter connected with financial services;
 - 3.2.1.3 preparing and submitting to the Minister recommendations for the introduction, amendment or replacement of legislation appertaining to financial services, companies and other forms of business structure;
 - 3.2.1.4 such functions in relation to financial services or such incidental or ancillary matters:
 - › as are required or authorised by or under any enactment, or
 - › as the States may, by Regulations, transfer; and
 - 3.2.1.5 such other functions as are conferred on the Commission by any other Law or enactment.

3.3 Guiding principles

- 3.3.1 The Commission's guiding principles require it to have particular regard to:
- 3.3.1.1 the reduction of risk to the public of financial loss due to dishonesty, incompetence, malpractice, or the financial unsoundness of persons carrying on the business of financial services in or from within Jersey;
 - 3.3.1.2 the protection and enhancement of the reputation and integrity of Jersey in commercial and financial matters;
 - 3.3.1.3 the best economic interests of Jersey; and
 - 3.3.1.4 the need to counter financial crime in both Jersey and elsewhere.

4 MiFID II equivalence

4.1 Introduction

- 4.1.1 Sections 4 and 5 provide a high-level analysis of the significant changes the Commission expects may need to be made to adapt Jersey's financial services regime to become MiFID II equivalent, should that be the desired outcome of this consultation process.
- 4.1.2 In general Jersey's financial services regime is principles based. MiFID II is much more prescriptive, consequently equivalence will likely require the Commission to draft (with the Law Draftsman as appropriate), consult upon and publish changes to financial services legislation and significantly more detailed CoP in order to demonstrate equivalence.
- 4.1.3 The MiFID II regulatory package comprises of a Directive, the 'Markets in Financial Instruments Directive (2014/65/EU)' (**MiFID**) and a companion Regulation, the Markets in Financial Instruments Regulation ((EU) No 600/2014) (**MiFIR**). This regulatory package succeeds the original Markets in Financial Instruments Directive (2004/39/EU) (**MiFID I**). The table below clarifies the context of the EU regulatory instruments concerned and the abbreviations used in this consultation paper.

MiFID I	MiFID II	
Directive	Directive (MiFID)	Regulation (MiFIR)
Markets in Financial Instruments <u>Directive</u> (2004/39/EU)	Markets in Financial Instruments <u>Directive</u> (2014/65/EU)	Markets in Financial Instruments <u>Regulation</u> ((EU) No.600/2014)

4.2 Definitions and financial instruments

- 4.2.1 MiFID II uses a different vocabulary from the FS(J)L. Integrating MiFID II terms into the FS(J)L would have the following effects:
- 4.2.1.1 MiFID II brings within its scope financial services and activities which are not defined as financial service business within the FS(J)L. Hence, for Jersey's financial services regime to become equivalent it would have to expand its list of regulated activities. An example is contained in MiFID recital 44, '*For the purposes of this Directive, the business of reception and transmission of orders should also include bringing together two or more investors, thereby bringing about a transaction between those investors*', which is known in the UK as 'arranging transactions'. Another example is '*High frequency algorithmic trading technique*'. The inclusion of the term high frequency trading brings with it several MiFID regulatory requirements, see subsection 4.10 of this consultation.
- 4.2.1.2 MiFID II uses different words to describe similar terms used in the FS(J)L. Article 2 of the FS(J)L defines '*Investment Business*', the MiFID equivalent is found in Annex I, section A and defined as '*Investment Services and Activities*'. The substitution of these types of MiFID II terms into the FS(J)L is unlikely to adversely impact Registered Persons and may yield some benefits.

- 4.2.2 Given MiFID II's use of new and different definitions, the Commission proposes to substitute and transpose, where necessary, MiFID II definitions into the FS(J)L. This will provide consistency of terms for Registered Persons who are operating in the EU.
- 4.2.3 The bulk of MiFID II's definitions are found in article 4 and Annex I, Sections: A, B & C of MiFID and article 2 of MiFIR.

Question 1 - Given the issues discussed above, would you support the introduction and substitution of MiFID II financial definitions into the FS(J)L where necessary? Please explain your reasons and the impact on your business.

4.3 Class D IB and MiFID's limited optional exemption

- 4.3.1 Article 3 of MiFID provides MSs with an optional exemption for persons who provide a very limited range of investment services. Based on the Commission's current understanding, this optional exemption could apply to a limited number of Class D IB Registered Persons.
- 4.3.2 The Commission understands that the exemption provides limited relief from: membership of an investor compensation scheme (providing the person has adequate professional indemnity insurance); certain financial resources requirements; and certain systems and controls requirements. The applicable conduct requirements remain unchanged.
- 4.3.3 The key criteria for the MiFID optional exemption are as follows.

- 4.3.3.1 The person is not allowed to:

- › Hold client funds or securities, nor be in debt of the client;
- › Provide any investment service, except the reception and transmission of orders in transferable securities and units in EU collective investment undertakings and/or the provision of advice in respect of those financial instruments; and
- › Passport their services across the EU

In the course of providing this investment service, the person may only transmit orders to:

- › MiFID authorised investment firms
- › CRR authorised credit institutions;
- › Branches of investment firms and credit institutions authorised in a third-country who are subject to, and comply with, at least as stringent rules to MiFID and CRR; and
- › Collective investment undertakings authorised by a MS to market units to the public and to managers of such undertakings.

Question 2 – The Commission welcomes comment from Class D Registered Persons and other Registered Persons as to whether it should apply this optional exemption to Class D Registered Persons who meet the above criteria.

The Commission advises respondents to consider the statement concerning financial resource requirements for equivalent Class D Registered Persons, authorised under MiFID, before making their comments, see paragraph 4.5.3 below.

4.4 Corporate Governance

- 4.4.1 The CoP provide detailed corporate governance requirements for Registered Persons. However, these will probably need enhancing to cover new requirements brought in by MiFID. MiFID article 9 incorporates most of its governance features from articles 88 and 91 of the ‘Capital Requirements Directive (2013/36/EU)’ (**CRD**).
- 4.4.2 MiFID makes Principal Persons explicitly accountable for how they define and oversee the governance of an investment firm, and sets a series of principles on how they must be supervised. The most significant difference between MiFID and Jersey’s Civil Financial Penalties regime with respect to governance appears to be the requirement for EU competent authorities to have the ability to fine individuals for breaches in the MiFID/CRR governance requirements. Penalties and fines are discussed in more detail in sub-section 4.12 of this consultation.
- 4.4.3 Other notable differences between the EU’s and Jersey’s financial services regimes are as follows:
- 4.4.3.1 MiFID limits the number of directorships the members of the ‘management body’ (Principal Persons in the FS(J)L) may hold. These are one executive role and two non-executive roles, or four non-executive roles, see CRD article 91. Within this requirement intra-group directorships are counted as one directorship; and directorships of not-for-profit organisations do not count for the purpose of MiFID.
 - 4.4.3.2 The Chairman and Chief Executive cannot share the same role, see CRD article 88.
 - 4.4.3.3 Large and complex firms are required to set up a nomination committee, see CRD article 88. The Commission expects that by EU standards, large and complex firms may approximate to the Financial Stability Board’s list of Systemically Important Financial Institutions (SIFIs).
 - 4.4.3.4 Principal Persons and especially nominations committees will have to demonstrate consideration of diversity in the composition of their boards, see CRD recital 60 and articles 88 and 91.

Question 3 – Would the introduction of MiFID’s enhanced governance requirements cause you or your firm any difficulties? Please explain your reasons.

4.5 Prudential

Initial capital, ANLA and ongoing financial resources requirements

- 4.5.1 Jersey’s financial services regime resources requirements differ by sector. Non-bank IB Registered Persons operate on a two tiered system of initial capital and a solvency risk ratio of total (risk) requirement to Adjusted Net Liquid Assets (**ANLA**). The total requirement is the sum of several risks: expenditure, position, counterparty and foreign currency. The ANLA

calculation determines the Registered Person's liquidity. A Registered Person must maintain an ANLA ratio of at least 110% to demonstrate its solvency.

- 4.5.2 MiFID II uses a similar approach to the above IB requirements. There is an initial capital requirement, but in place of ANLA has an '*own funds*' requirement. MiFID through article 15, makes use of the Capital Requirements regulatory package (**CRD IV**), which consists of CRD and the Capital Requirements Regulation ((EU) No 575/2013)) (**CRR**). Unlike Jersey's ANLA ratio, CRD IV requires investment firms to maintain a minimum level of liquid own funds. The own funds requirement varies according to the activities, size and complexity of the investment firm. It consists of several risk factors akin to Jersey's CoP, which may or may not apply depending on the nature of the activities of the investment firm. However, the underlying calculations of the risk factors are generally more complex than Jersey's.
- 4.5.3 With respect to Class D IB Registered Persons, who had decided not to use the optional exemption (that is potentially available under article 3 of MiFID), it is the Commission's understanding that the CRD IV requirements would mean that these Registered Persons would have to maintain an initial capital requirement of €50,000 and a level of professional indemnity insurance of up to €1,000,000 per claim, and in aggregate €1,500,000 per annum for all claims. These requirements are flexible, in that the investment firm can be authorised through a combination of professional indemnity insurance and capital to provide the same level of cover.
- 4.5.4 The Commission also draws stakeholder attention to a recent report published by the European Banking Authority (**EBA**) which supervises the implementation of CRD IV. The report⁶ calls for a simpler approach to the calculation of the own funds requirement for investment firms that do not represent a systemic risk to the financial sector. This new simpler approach could be in place before the end of the decade and possibly before MiFID II enters into force.
- 4.5.5 The Commission will undertake further analysis on this topic, as to whether it would be necessary to amend the CoP financial resources requirements.

Question 4 – The Commission is very interested to receive comment from Registered Persons who have experience of the EU financial resources requirements compared with Jersey's. Please comment on your experience of the two systems?

Investor Compensation Scheme

- 4.5.6 MiFID article 14 broadly requires investment firms to be members of an Investor Compensation Scheme. Provision for an investor compensation scheme is written in article 27 of the FS(J)L. This has not been enabled, and may have to be for Jersey financial services regime to become equivalent.
- 4.5.7 MiFID article 14 refers to the Investor Compensation Scheme Directive (97/9/EC) (**ICSD**). The ICSD provides protection for investors where an investment firm fails to honour its obligations for client cash and securities that it holds on the client's behalf. The level of compensation is set at 90% of the relevant client assets, to a maximum of €20,000 per client.
- 4.5.8 Commission analysis has found that EU MSs finance their Investor Compensation Schemes through levies on investment firms that typically range between 0.2% and 0.4% of a firm's IB

⁶ <http://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-20+Report+on+investment+firms.pdf>

revenues. The level of the levy is typically subject to controlling factors such as: the number of clients a firm has, income earned, value of assets managed or advised by the firm, and whether the firm holds client assets or not. The UK's Financial Services Compensation Scheme (**FSCS**) goes beyond the scope of the ICSD. In the UK the FSCS includes mis-selling of investments, and the maximum level of compensation is £50,000 per client. Consequently, the UK's levy is proportionately higher than it would be if it only matched the minimum requirements of the ICSD.

Question 5 – Would you support the introduction of a Jersey Investor Compensation Scheme, based on the minimum required EU level of cover, taking into account the potential levy on your IB revenues, if it was a necessary condition for equivalence?

4.6 Conduct

- 4.6.1 Through its CoP Jersey has a well-developed conduct regime; however, MiFID II introduces a number of new features that should be considered by stakeholders, and may be necessary for equivalence. The MiFID I framework with respect to conduct is secured on the principle that investment firms must act in 'the best interests' of their clients. MiFID II strengthens the application of this principle with more developed text on the design and distribution of investment products (including structured deposits), investment advice, portfolio management and remuneration of client facing employees. The bulk of the text concerning conduct is found in recitals 39, 70 to 88 and articles 23 to 30 of MiFID.

Client categorisation

- 4.6.2 As stated above, one of the strong incentives for Jersey financial services regime to seek MiFID II equivalence is to provide the opportunity for Registered Persons to solicit per se professional clients across the EU. Understanding how MiFID categorises per se professional clients is key to unlocking this opportunity.
- 4.6.3 Both Jersey's CoP and MiFID use three identical terms to define three classes of client: per se professional, retail and elective professional. However, client classification under MiFID has complex elements that are subject to further clarification through future delegated acts. In the absence of the final text on this topic, the Commission understands that MiFID defines and describes the three client categories as follows:
- 4.6.3.1 MiFID per se professional clients include all persons engaged in financial services activity, in MiFID defined financial instruments, for commercial gain (known in MiFID as 'professional investors'). Also included in the per se professional group are 'large undertakings', who are purchasers of financial services, such as trusts, foundations and ultra high net worth individuals (through legal personality), who are subject to the threshold requirements set out below.
- 4.6.3.2 A professional client is deemed to possess '*the experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs.*' Professional clients may waive the benefit of certain detailed rules of conduct and investor protections. The extent of these waivers and those waivers existing in Jersey's CoP will need to be considered as part of a MiFID II equivalent regime.
- 4.6.3.3 The definition of an 'eligible counterparty' and the associated conduct exemptions are set out in MiFID article 30. In summary, an eligible counterparty is a per se

professional investor conducting eligible counterparty business that is dealing on behalf of clients, and/or their own account and/or engage in arranging transactions. Eligible counterparties are exempt from a series of conduct requirements, such as best execution.

- 4.6.4 Jersey’s CoP use an almost identical approach to defining large undertakings with slightly lesser thresholds of monetary value, see the table below. As part of a MiFID II equivalence process the CoP may have to be amended to match MiFID standards. MiFID Annex II section I.2 sets out the size requirements for large undertakings.

Jersey Large Undertaking	EU Large Undertaking
Balance Sheet Assets – not less than £13,000,000 ≈ €16,346,200	Balance Sheet Assets – not less than €20,000,000
Net turnover - £26,000,000 ≈ €32,692,400 or greater	Net turnover - €40,000,000 or greater
Net Assets - £1,300,000 ≈ €1,634,620 or greater	Net Assets - €2,000,000 or greater

- 4.6.5 Both Jersey CoP and MiFID define a retail client by not being a professional client. They also share similar mechanisms by which a retail client may become an elective professional client. However MiFID, via Annex II section II.1, adds a detailed client assessment obligation on the investment firm before the client may be treated as a professional. Once the client is designated as an elective professional investor, the client may be exempted from the same conduct requirements as a professional client and more when acting as an eligible counterparty, subject to the knowledge and circumstances of the client.
- 4.6.6 Initial stakeholder engagement has identified a small number of professional clients serviced by IB Registered Persons. However, anecdotal evidence suggests that IB Registered Persons routinely classify their clients as retail, even though some of these clients could qualify as professionals.

Question 6a – What impact would having, or not having, the EU passport to access per se professional investors (not elective professional investors) have on your business?

Question 6b – What impact would adopting MiFID’s thresholds, tests and exemptions for elective professional investors into Jersey’s CoP have on your business?

Question 6c – What impact would not having the resultant reputational ‘kite mark’ brought by MiFID II equivalence have on your retail client business?

Other Conduct requirements

- 4.6.7 MiFID contains a number of other conduct requirements that either differ or exceed Jersey’s CoP. Jersey’s CoP may have to be amended to demonstrate equivalence with these new

requirements. The Commission has identified below those amendments that appear to be the most significant.

Product Manufacturers

4.6.7.1 MiFID requires that the manufacturers of financial products must identify a target market for their products, make sure that their distribution strategy is consistent with that target market, and regularly review whether the product continues to address the needs of that target market, see article 16.3 of MiFID. This is not currently a requirement in Jersey's IB CoP.

Appropriateness

4.6.7.2 For IB activity that is neither portfolio management nor investment advice, a Registered Person under MiFID would be required to conduct an appropriateness assessment on the client before selling certain financial products. Where the Registered Person deems that the product or service is inappropriate for the client, the Registered Person must warn the client of their opinion, see article 25.3 of MiFID. Although there is a suitability regime for advised business, Jersey's IB CoP do not have the above appropriateness requirements.

4.6.7.3 However IB firms offering execution only services under MiFID, may provide this service without an appropriateness test for a restricted list of non-complex financial instruments to their clients, see article 25.4(a) of MiFID. Therefore it would be important for Registered Persons to differentiate between complex and non-complex financial instruments.

Best Execution

4.6.7.4 Under MiFID, best execution is defined in terms of total consideration of the trade, which includes all fees and charges, see article 27 of MiFID. This differs from Jersey's CoP which focus primarily on the transaction price of the security, see article 2.22 of the CoP for IB.

Commissions, fees, costs and charges

4.6.7.5 MiFID requires the absolute disclosure of all costs and charges associated with providing an investment service or holding a financial instrument, *'which are not caused by the occurrence of underlying market risk'*, see MiFID article 24.4.

4.6.7.6 Firms providing independent advice or portfolio management are forbidden from receiving third-party commissions, fees or other inducements, see recital 74 and article 24.7(b) of MiFID. Currently, under Jersey's IB CoP this restriction only applies to advice, where the client is a Jersey resident retail investor.

4.6.7.7 There is also a general prohibition on the payment or receipt of commissions and fees by investment firms, unless the payments enhance the quality of the client's service and are in the client's best interest, see article 24.9 of MiFID.

Conflicts of interest and staff remuneration

4.6.7.8 Article 23 of MiFID imposes obligations on investment firms with respect to conflicts of interest. Firms must take all appropriate steps to identify, prevent or manage conflicts of interest. If these steps are not sufficient to properly manage the

conflict, disclosure may be used as a last resort. Jersey's CoP, paragraphs 2.9 and 2.10 would need to be strengthened to meet MiFID II's requirements.

- 4.6.7.9 Article 24.10 requires that the investment firm does not remunerate or assess the performance of its staff in a way that conflicts with its duty to act in the client's best interests. This is not currently a requirement in Jersey's financial services regime, other than within the CoP principle to avoid conflicts of interest.

Question 7 – The Commission expects that in order to meet MiFID equivalence Jersey's CoP would have to address the points made in paragraphs 4.6.7.1 to 4.6.7.9 above.

Please provide your comments on the impact of any of the following will have on your business:

1. Product manufacturers;
2. Appropriateness;
3. Best execution;
4. Commission, fees, costs and charges; and
5. Conflicts of interest and remuneration.

4.7 Internal systems and controls

- 4.7.1 The Commission's analysis of MiFID article 16 finds three areas where the Commission expects that the CoP would need expanding with respect to internal systems and controls, these concern: information security, recording of telephone conversations and electronic communications, and additional safeguards for client assets.
- 4.7.2 In keeping with increasing concerns of data security, MiFID article 16.5, paragraph 3, places specific standards on investment firms to have systems in place: to guarantee the security and authentication of information transfer; to minimise the risk of data corruption and unauthorised access; and to prevent leakage of information, in order to retain confidentiality of data. The European Commission will publish delegated acts providing more specification on this topic.
- 4.7.3 MiFID article 16.7, sets out requirements for recording telephone conversations and retention of electronic communications. The Commission understands that the baseline requirements are that an investment firm must record and retain communication when it is dealing on its own account or for clients, when concerning the reception, transmission and execution of their orders. The requirement extends to where the communications '*are intended to result in transactions ... even if those conversations or communications do not result in the conclusion of such transactions ...*'. These records have to be retained for up to 7 years. The European Commission will publish delegated acts providing more specification on this topic.
- 4.7.4 MiFID adds the new requirement which forbids pledged collateral (financial instruments) of retail clients from being used by the investment firm, as its own resources, without the consent of the client, see MiFID article 16.10. This requirement is not within the scope of the Financial Services (Investment Business (Client Assets)) (Jersey) Order 2001. The European Commission has recently published (7 April 2016) a MiFID II Delegated Directive. Chapter II

of the Delegated Directive provides more detail on the requirements concerning the safeguarding of client financial instruments and funds.

Question 8 – Please comment how any of the statements in sub-section 4.7 concerning Internal Systems and Controls will impact your business.

4.8 Transaction reporting

- 4.8.1 MiFIR considerably adds to the quantity of data available to detect and deter market abuse, and to monitoring the orderly functioning of the markets, see MiFIR recitals 32 to 36 and articles 24 to 27. For equivalence these requirements would have to be incorporated into the FS(J)L and/or CoP. The Commission lists some of the most significant new requirements below.
- 4.8.2 Investment firms executing and concluding transactions in financial instruments (including an index or basket) that trade on a regulated market, MTF or OTF, must report these transactions to the responsible competent authority⁷, by themselves, through the trading venue, or through an Approved Reporting Mechanism (**ARM**), by the close of next business day. Details must include information on the security traded, the client and the person or algorithm responsible for the trade. Investment firms that receive and transmit orders must either report the trade or provide detailed order information to the firms executing their orders, so that the order executing firms may fulfil their transaction reporting obligations.
- 4.8.3 Clients who are legal persons, must have a Legal Entity Identifier in order to fulfil the transaction reporting requirements set out in MiFIR article 26.6.

Question 9 – Please offer your comments on the transaction reporting requirements outlined in sub-section 4.8 above.

4.9 Derivatives with an ESMA trading obligation

- 4.9.1 Article 28 of MiFIR references the derivatives trading activities of EMIR defined financial and non-financial counterparties. Here the requirement is that all derivatives that are subject to an ESMA trading requirement⁸ must be traded on a Regulated Market, MTF or OTF. The FS(J)L and/or CoP do not have these requirements and therefore may have to be amended to reflect this requirement in order to achieve equivalence.
- 4.9.2 Derivatives subject to a trading obligation, may only be traded on third-country venues if they are deemed equivalent by the European Commission.
- 4.9.3 Derivatives subject to a trading obligation are also subject to an EMIR clearing obligation. A more detailed discussion on EMIR and how its requirements interact with MiFID II is set out in Section 5 below.

Question 10 – If MiFIR's derivatives trading obligation were to apply in Jersey's financial services regime, how would its requirements affect your business?

⁷ The supervising authority of the regulated market, MTF or OTF

⁸ The procedure by which ESMA identifies derivatives subject to a trading obligation is set out in article 32 of MiFIR

4.10 Investment firms and algorithmic trading

- 4.10.1 MiFID II introduces requirements on investment firms that are engaged in algorithmic trading. These firms are required to have effective systems and risk controls suitable for their businesses. This is to ensure that their trading systems are resilient and have sufficient capacity for their scale of operation, and that there are appropriate trading thresholds, with limits, and mechanisms to prevent erroneous trades. These systems must also prevent the creation of, or contribution to, a disorderly market. There are additional requirements for high frequency algorithmic traders and algorithmic market makers, see MiFID article 17. Jersey's CoP, paragraph 3.2, include '*Internal Systems and Controls*', this paragraph may need to include these requirements in order to demonstrate equivalence.
- 4.10.2 The onus on maintaining fair and orderly markets rests with regulated markets and trading venues who are required to have resilient systems to cope with algorithmic trading and in particular high frequency trading, see MiFID articles 48 to 50.
- 4.10.3 As the Commission does not have any trading venues under its supervision, MiFID's supervisory requirements for trading venues do not apply to the jurisdiction. However, MiFID's supervisory requirements on algorithmic traders, some of whom do have a presence in Jersey, are a consideration for the Commission as it reviews the FS(J)L and CoP for MiFID II equivalence.

Question 11 – The Commission is keen to receive comments from any Registered Persons who are engaged in algorithmic trading, and how they plan to adapt to the new requirements set out in MiFID.

4.11 Miscellaneous requirements

- 4.11.1 This sub-section briefly reviews two MiFID II topics: trading rules for equity investments and commodity derivatives position limits.
- 4.11.2 MiFID requires that shares admitted to trading on a regulated market or trading venue must either trade on a regulated market, MTF, through a Systematic Internaliser^{9, 10}, through a European Commission approved equivalent third-country trading venue, or between eligible/professional counterparties provided that the trades do not contribute to the price discovery process.
- 4.11.3 The Commission believes that these requirements are not onerous for Registered Persons, who in the main transmit their orders to trading venues outside of Jersey and do not participate in market making activities. However the FS(J)L and CoP may have to be amended to demonstrate equivalence with this aspect of MiFID. For example the FS(J)L does not recognise Systematic Internalisers and only makes limited reference to market makers through persons who '*deal as principal*', see Schedule 2, section 4 of the FS(J)L. There are no specific requirements for market makers or Systematic Internalisers in the CoP.

Question 12 – The Commission is keen to receive comment on these MiFID requirements from any Registered Person who would describe themselves as a market maker or Systematic Internaliser.

⁹ Systematic Internaliser, defined in article 4.1(20) of MiFID.

¹⁰ ESMA/2015/1464 table 41, p343

- 4.11.4 MiFID II introduces position limits for commodity derivatives to counter market abuse and support orderly functioning of the markets. MSs will set position limits that a person (natural or legal) may hold in commodity derivatives that are either traded on a public venue or Over-the-Counter (**OTC**). Whilst the MSs will set their national position limits, ESMA will design the methodology for calculating position limits, see article 57 of MiFID.
- 4.11.5 The FS(J)L and CoP do not set position limits for Registered Persons engaged in commodities derivatives activities. Consequently, the Commission would have to consider these MiFID II requirements as part of an equivalence review. The text concerning the possible band of position limits for commodity derivatives is complex and not finalised. However, in very simplified terms ESMA's advice¹⁰ is that MSs should set position limits between 5% and 35%, on a baseline of 25%, of the deliverable supply for the spot month contract, or of the average annual open interest for other months.

Question 13 – The Commission understands that a limited number of Registered Persons do take significant positions in commodity derivatives, some may be holding positions within and above the position limit bands mentioned above. Hence, the Commission welcomes comment from Registered Persons, who engage in commodities trading, on this MiFID II requirement and ESMA's indicated range of MS position limits.

4.12 Regulators – sanctions and power of intervention

- 4.12.1 With respect to sanctions for contraventions of MiFID services and activities, the Financial Services Commission (Jersey) Law 1998 and MiFID II sanctions regime are fairly comparable except for the differences discussed below. The core of MiFID's sanctions regime is set out in MiFID article 70, where there is a lengthy list of infringements for non-compliance with specified articles in MiFID and MiFIR, these materially expand the detail of the text found in MiFID I. The context is to create a level playing field in sanctions across the EU.
- 4.12.2 The Commission through its interpretation of MiFIR recital 42 (which describes how the European Commission determines third-country regime equivalence '*... third-country regulatory and supervisory framework achieves similar and adequate regulatory effects and to what extent it meets the same objectives as Union law.*') understands that equivalent application of MiFID article 70 will very probably be a crucial test of equivalence.
- 4.12.3 MiFID article 70.6 details the range of administrative sanctions that MSs must make available to their competent authorities. The Commission currently has the power to make use of all the types of administrative sanction listed in MiFID article 70.6, with one potentially crucial exception, the Commission does not currently have the power to fine natural persons¹¹.
- 4.12.4 Another material difference concerns the level of administrative fines that a competent authority may place on legal and natural persons. These are set out in MiFID article 70.6(f), (g) and (h), and are summarised as follows:
- 4.12.4.1 Maximum fines for legal and natural persons must be at least €5,000,000 ≈ £4,000,000; or
- 4.12.4.2 For legal persons, up to 10% of turnover as stated in the consolidated accounts of the legal person; and

¹¹ Unless the natural person is a Registered Person.

- 4.12.4.3 Maximum fines must be at least twice the amount of the benefit derived, even if that exceeds the €5,000,000 or of 10% turnover parameter mentioned above.
- 4.12.5 In Jersey, fines are capped under the Financial Services Commission (Financial Penalties) (Jersey) Order 2015 at 8% of income up to a maximum of £4,000,000. This level does not match the 10% turnover requirement or the benefit derived requirement. Consequently, the thresholds may have to be increased and amended to achieve equivalence.
- 4.12.6 Another new requirement in MiFID, recital 29 and articles 39 to 43, is the obligation on competent authorities to monitor the markets in financial instruments and where appropriate, to ban or restrict the sale of financial instruments, activities or practices. Included within MiFID is the provision for competent authorities to proactively investigate new products or financial instruments before they are marketed. Competent authorities may impose bans or restrictions on the grounds of investor protection, a threat to the orderly functioning of financial and commodity markets, financial stability or price formation.
- 4.12.7 The Commission does not have explicit powers to restrict a financial instrument, a financial activity or practice on the grounds mentioned in the above paragraph. However, these powers are effectively in place by virtue of Article 23 of the FS(J)L, which gives the Commission firm-specific powers of intervention through issuing directions that could be equally applied against a financial instrument, activity or practice that originates in Jersey. It may be required to draft more specific text in the FS(J)L to demonstrate equivalence with this aspect of MiFID.

Question 14 – The Commission welcomes stakeholder comment on sub-section 4.12 with respect to sanctions and powers of intervention.

5 EMIR within MiFID II

5.1 The EU context

- 5.1.1 The EU introduced EMIR as part of its response to the G20 requirements concerning derivatives trading, clearing and collateral. MiFIR recital 44 makes the G20 commitments and agreements part of the *third-country* equivalence assessment process, ‘... *decisions determining third-country regulatory and supervisory frameworks as equivalent to the regulatory and supervisory framework of the Union should be adopted only if the legal and supervisory framework of the third country provides for an effective equivalent system for the recognition of investment firms authorised under foreign legal regimes in accordance with, amongst others, the general regulatory goals and standards set out by the G-20 in September 2009 of improving transparency in the derivatives markets, mitigating systemic risk, and protecting against market abuse.*’
- 5.1.2 Sub-section 4.9 briefly outlines MiFID’s trading requirements for derivatives subject to an ESMA trading obligation, which links MiFID II with EMIR.
- 5.1.3 By default, derivatives subject to a trading obligation are also subject to an ESMA clearing obligation. In addition to derivatives subject to a trading obligation, the clearing obligation requires most OTC derivatives contracts to be cleared through a Central Counterparty (**CCP**). Those derivatives contracts not subject to the clearing obligation are subject to enhanced risk mitigation rules, such as increased collateral requirements. EMIR also introduces a ‘reporting obligation’, requiring all derivatives contracts to be reported to Trade Repositories.
- 5.1.4 The remainder (and bulk) of EMIR develops a regulatory framework for the authorisation and supervision of CCPs and registration and supervision of Trade Repositories. EMIR permits the recognition of third-country CCPs and Trade Repositories, subject to an equivalence assessment by ESMA.

5.2 The Commission’s proposal

- 5.2.1 The Commission’s suggested policy response to EMIR and the G20 requirements that overlay its introduction is to steer Jersey counterparties into the EU regime:
- 5.2.1.1 By requiring derivatives that are subject to an ESMA trading obligation to trade on an EU or EU equivalent regulated market, MTF or OTF, as proposed in sub-section 4.9;
- 5.2.1.2 For derivatives that are subject to an ESMA clearing obligation to clear through an EU authorised CCP or an EU recognised equivalent CCP;
- 5.2.1.3 For Jersey counterparties entering into derivatives contracts not subject to a clearing obligation to employ EU equivalent risk mitigation techniques;
- 5.2.1.4 That all derivatives contracts, concluded, modified or terminated by Jersey counterparties are reported to an EU registered trade repository or an EU recognised equivalent trade repository; and
- 5.2.1.5 The Commission would transpose, where necessary, all the relevant derivatives definitions and terms from MiFID and EMIR to ensure legal consistency in the application of regulatory equivalence.

- 5.2.2 The Commission's envisaged proportionate response to MiFID II equivalence is not to include the authorisation and registration of CCPs and Trade Repositories, unless this specific activity is undertaken in Jersey.

Question 15 - Please comment on the Commission's policy proposal as set out in Section 5 with respect to derivatives.

6 Cost benefit analysis

6.1 Introduction

- 6.1.1 The Commission is framing its cost benefit analysis of implementing a MiFID II equivalent regime in relation to costs and benefits that occur in Jersey if the jurisdiction proceeds with this initiative. Therefore this analysis will exclude the 'sunk' costs made by firms who as a matter of group policy are already implementing MiFID II policies, procedures and systems.

6.2 Costs to industry

- 6.2.1 **Financial resources** – sub-section 4.5 considers the prudential aspects of MiFID II. It appears to the Commission that adapting to the MiFID II requirements will involve Registered Persons incurring one-off costs associated with identifying the prudential requirements associated with their business activities. This would be followed by one-off investments in systems to calculate the value of their prudential obligations and monitoring of compliance with those obligations on an ongoing basis. At this stage it is difficult to establish whether prudential requirements will increase, decrease or be unchanged for Registered Persons until analysis has been conducted of the effects on a representative sample of Registered Persons.
- 6.2.2 **Investor compensation scheme** – The levy necessary to establish and operate an investor compensation scheme, as referred to in sub-section 4.5.
- 6.2.3 **Compliance with more prescriptive CoP** – the Commission foresees that the introduction of a MiFID II equivalent regime to Jersey's financial services regime would result in more detailed CoP and in some cases introduce additional obligations as set out in this paper. Registered Persons without an EU connection may find this an additional burden. Registered Persons with an EU connection, should experience some benefit, through the use of common EU definitions and similar regulatory text.
- 6.2.4 **Wider regulated community** – MiFID II potentially increases the number of IB firms brought within its scope. As a consequence, firms not currently regulated under Jersey's IB regime, but conducting MiFID II investment services and activities, will be subject to regulatory authorisation, supervision and fees.

6.3 Costs to the Commission

- 6.3.1 **Increased market monitoring responsibilities** – MiFID obliges the Commission to take a proactive role in monitoring the issue of MiFID financial instruments (and products), activities and practices. This would require the Commission to increase its supervisory resources to cover this obligation.
- 6.3.2 **Wider regulated community** – MiFID II increases the number of IB firms brought within its scope. As a consequence the Commission may find that it has more Registered Persons to supervise, which would require a proportionate increase in supervisory resources.
- 6.3.3 **Policy development, drafting of Law and CoP** – the introduction of a MiFID II equivalent regime will require drafting of new and/or amended primary legislation and CoP. This will require considerable time and resources from the Commission, Government and Law Draftsman's Office.
- 6.3.4 **International engagement** – in parallel with developing new and/or amended primary legislation and CoP for a MiFID II equivalent regime, the Commission will have to increase its

engagement with EU stakeholders, particularly with the European Commission and ESMA to ensure successful progression in the equivalence decision process. Again this will require the Commission's time and resources.

6.4 Benefits

- 6.4.1 **Preserves and enhances the level of access to EU market** – Jersey's financial services sector access to EU markets is currently contingent on a patchwork of national regimes. The introduction of MiFID II will lead to a more harmonised framework of access for third-countries. If Jersey's financial services regime becomes MiFID II equivalent, EU MSs are more likely to treat Jersey's Registered Persons more favourably than investment firms in non-equivalent regimes in terms of accessing their investors.
- 6.4.2 **Reputation and consumer protection** – MiFID II, and thereby Jersey's MiFID II equivalent financial services regime, aims to raise standards of investor protection and market transparency. The adoption of a MiFID II equivalent regime would enhance the Island's reputation as a safe place for investor assets. Industry comment foresees that MiFID II compliance will carry its own kite mark of quality.
- 6.4.3 **Opens new markets for professional investors across the EU** – the significant economic opportunity for Jersey's financial services sector, if Jersey's financial services regime becomes a MiFID II equivalent, is the EU passport to offer services to professional investors across the EU, without need for authorisation or a physical presence within a MS. If Jersey's financial services regime becomes MiFID II equivalent, then a Registered Person only needs to be registered by ESMA in order to access the EU professional investor passport, see MiFIR article 46.
- 6.4.4 **Commonality of regulatory definitions between Jersey and the EU** – commonality of definitions will reduce complexity for Registered Persons who are operating in the EU.
- 6.4.5 **Greater certainty of expectations** – Industry has remarked that more detailed CoP will provide greater certainty of expectations between Registered Persons and the Commission. This should lead to smoother interactions between the Registered Persons and the Commission.

Question 16a – Given the comments and opinions expressed in this consultation paper, do you agree or disagree with the consultation paper's proposal that Jersey's financial services regime should seek to become MiFID II equivalent?

Question 16b – Should the Commission apply MiFID II standards to all investment business, irrespective of the location of the client?

Please support your opinion with comment. If you are a Registered Person, or a person conducting MiFID defined investment services and activities, please summarise your anticipated costs (excluding any sunk costs referred to in paragraph 6.1.1 above) and benefits, and likely net position.

The Commission will not make public Registered Person specific data.

7 Summary of questions

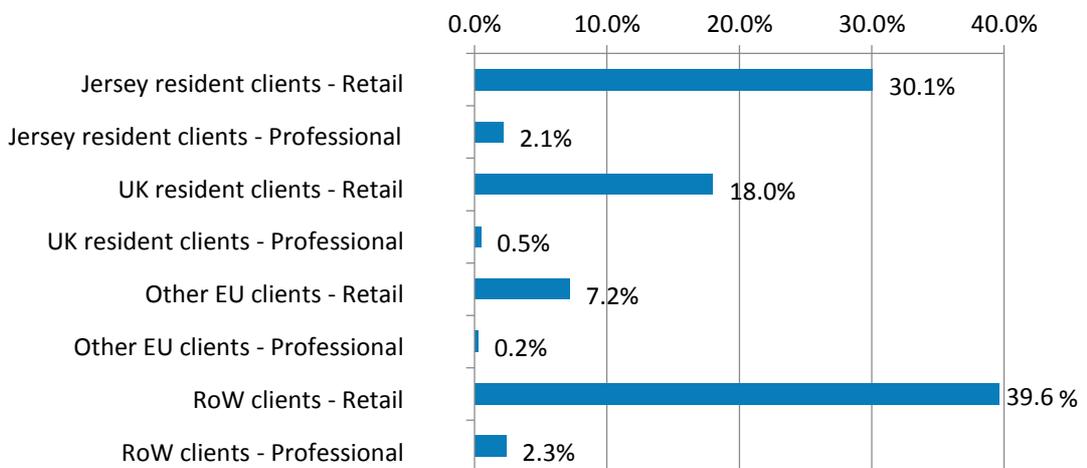
Page	Question
14	<p>Question 1 - Given the issues discussed above, would you support the introduction and substitution of MiFID II financial definitions into the FS(J)L where necessary? Please explain your reasons and the impact on your business.</p>
14	<p>Question 2 – The Commission welcomes comment from Class D Registered Persons and other Registered Persons as to whether it should apply this optional exemption to Class D Registered Persons who meet the above criteria.</p> <p>The Commission advises respondents to consider the statement concerning financial resource requirements for equivalent Class D Registered Persons, authorised under MiFID, before making their comments, see paragraph 4.5.3 below.</p>
15	<p>Question 3 – Would the introduction of MiFID’s enhanced governance requirements cause you or your firm any difficulties? Please explain your reasons.</p>
16	<p>Question 4 – The Commission is very interested to receive comment from Registered Persons who have experience of the EU financial resources requirements compared with Jersey’s. Please comment on your experience of the two systems?</p>
17	<p>Question 5 – Would you support the introduction of a Jersey Investor Compensation Scheme, based on the minimum required EU level of cover, taking into account the potential levy on your IB revenues, if it was a necessary condition for equivalence?</p>
18	<p>Question 6a – What impact would having, or not having, the EU passport to access per se professional investors (not elective professional investors) have on your business?</p> <p>Question 6b – What impact would adopting MiFID’s thresholds, tests and exemptions for elective professional investors into Jersey’s CoP have on your business?</p> <p>Question 6c – What impact would not having the resultant reputational ‘kite mark’ brought by MiFID II equivalence have on your retail client business?</p>
20	<p>Question 7 – The Commission expects that in order to meet MiFID equivalence Jersey’s CoP would have to address the points made in paragraphs 4.6.7.1 to 4.6.7.9 above.</p> <p>Please provide your comments on the impact of any of the following will have on your business:</p> <ol style="list-style-type: none"> 1. Product manufacturers; 2. Appropriateness; 3. Best execution; 4. Commission, fees, costs and charges; and 5. Conflicts of interest and remuneration.

Page	Question
21	Question 8 – Please comment how any of the statements in sub-section 4.7 concerning Internal Systems and Controls will impact your business.
21	Question 9 – Please offer your comments on the transaction reporting requirements outlined in sub-section 4.8 above.
21	Question 10 – If MiFIR’s derivatives trading obligation were to apply in Jersey’s financial services regime, how would its requirements affect your business?
22	Question 11 – The Commission is keen to receive comments from any Registered Persons who are engaged in algorithmic trading, and how they plan to adapt to the new requirements set out in MiFID.
22	Question 12 – The Commission is keen to receive comment on these MiFID requirements from any Registered Person who would describe themselves as a market maker or Systematic Internaliser.
23	Question 13 – The Commission understands that a limited number of Registered Persons do take significant positions in commodity derivatives, some may be holding positions within and above the position limit bands mentioned above. Hence, the Commission welcomes comment from Registered Persons, who engage in commodities trading, on this MiFID II requirement and ESMA’s indicated range of MS position limits.
24	Question 14 – The Commission welcomes stakeholder comment on sub-section 4.12 with respect to sanctions and powers of intervention.
26	Question 15 - Please comment on the Commission’s policy proposal as set out in Section 5 with respect to derivatives.
28	<p>Question 16a – Given the comments and opinions expressed in this consultation paper, do you agree or disagree with the consultation paper’s proposal that Jersey’s financial services regime should seek to become MiFID II equivalent?</p> <p>Question 16b – Should the Commission apply MiFID II standards to all investment business, irrespective of the location of the client?</p> <p>Please support your opinion with comment. If you are a Registered Person, or a person conducting MiFID defined investment services and activities, please summarise your anticipated costs (excluding any sunk costs referred to in paragraph 6.1.1 above) and benefits, and likely net position.</p> <p>The Commission will not make public Registered Person specific data.</p>

Appendix A – MiFID II sensitivity analysis

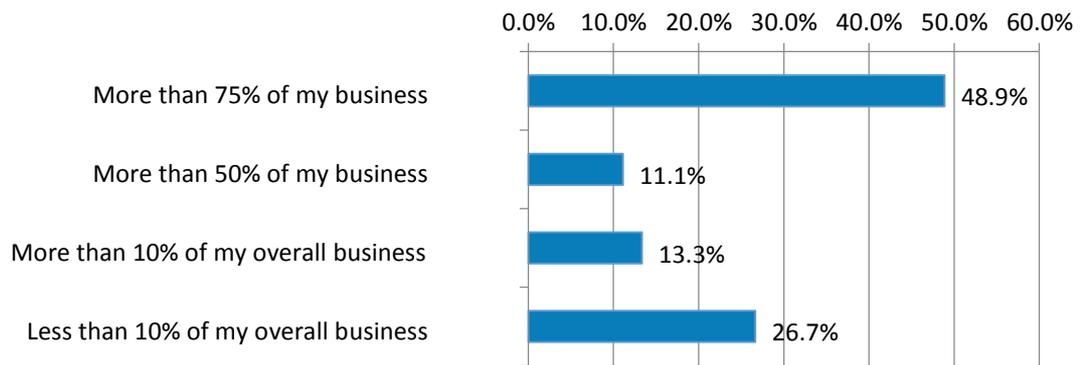
1. The Commission’s initial MiFID II analysis identified a population of 90 IB licensed Registered Persons, as having the greatest business exposure to the MiFID II’s third-country provisions. Possibly also affected are less than 10 fund services businesses, who give advice without an IB licence; and an unknown number of service providers to Professional Investor Regulated Schemes (**PIRS**), who could be within the scope of the regulatory package.
2. To improve the Commission’s knowledge of the Jurisdiction’s sensitivity to MiFID II, Commission staff conducted a SurveyMonkey survey of IB Registered Persons in December 2014. The Commission received 45 replies (half of the population); a high response rate that provided Commission staff with robust data bounded by 90% and 95% confidence intervals. Appendix B contains a summary of the survey’s statistics.
3. We list a selected sample of those statistics below:
 - a. Our sample of IB entities reported that they had in total 84,875 clients on their books.
 - b. The largest geographic location of those clients was in the Commission’s ‘Rest of World’ resident category 41.9%: not Jersey, not UK, nor other *EU*. The second largest proportion, 32.2% were Jersey resident. The third largest, 25.9% were *EU* resident, the client sub-group that falls within the scope of MiFID II. This *EU* sub-group is subdivided between UK (18.5%) and other *EU* (7.4%) resident (see chart below).

The geographic location and classification of Jersey IB clients



- c. For nearly 49% of our sample, IB licensed activity was greater than 75% of overall income. We also identified a second peak, for nearly 27% of the sample, where Investment Business licensed activity was less than 10% of overall business (see chart below).

IB income as a percentage of overall income



- d. Our survey revealed that a material proportion (25.9%) of Jersey’s IB clients fell within the scope of MiFID II. Nearly half the sample (48.9%) derived more than 75% of its income from IB licensed revenues. The Commission understands that IB profits are sensitive to operating leverage. Hence, the Commission hypothesised that restricted access to EU clients brought on by the implementation of MiFID II could exert a negative leveraged effect on the industry’s profitability.
4. Commission staff held a briefing and discussion session with IB Registered Persons and other stakeholders (30th April 2015). The briefing covered the following topics:
 - a. The background to the development of MiFID II;
 - b. How the regulatory package cross references other EU Directives and Regulations (CRD/CRR, MAD/MAR and others);
 - c. The third-country regime and how third-country jurisdictions may seek equivalence so that third-country firms may gain access to EU professional clients without need for further authorisation;
 - d. A briefing of the results of the Survey Monkey survey; and
 - e. A summary of what being MiFID II compliant may mean to a Jersey IB Registered Persons.
 5. The briefing and discussion was attended by over 20 Registered Persons. Commission staff observed that nobody spoke out as having any specific conflicts with implementing Jersey’s financial services regime, where the influence of MiFID I was a consideration. There was a consensus that where firms had issues of interpretation of Jersey’s financial services regime that they sought guidance from the UK’s FCA handbook (MiFID I compliant) to fill in any gaps. Nobody voiced any concerns in implementing MiFID II’s standards of conduct. As to what Jersey should do, the consensus without vocal dissent was that Jersey should seek equivalence with MiFID II.
 6. To gain greater insight into the thoughts of the IB Registered Persons, Commission staff, frequently joined by a representative of the Chief Minister’s Department, embarked on a series of one-on-one meetings with stakeholders who attended the 30th April MiFID II briefing and discussion. Commission staff met with 19 IB Registered Persons; their collective sentiment is summarised in the following paragraphs.

- a. Seventeen out of 19 IB firms expressed a wish that Jersey financial services regime should seek MiFID II equivalence. The strength of this view ranged from strong conviction to qualified support (in the absence of further information). The common theme running through all those who supported equivalence was that it was a means to demonstrate that Jersey was compliant with international standards – *‘which is good for business’*. Others with a professional client offering said that it gave them the opportunity to assess strategic opportunities provided by the EU passport for professional investors.
- b. Of the 17 firms that support Jersey’s financial services regime seeking MiFID II equivalence, all had either completed, or were nearing completion, of a transition from a transactions based business model to a recurring fee model – under the influence of RDR/RFA. The two firms that were against Jersey seeking equivalence to MiFID II were still running transaction models (outside RDR/RFA), these only seemed to continue to function in the Middle East and Asia.
- c. We asked 13 firms what they thought was Jersey’s unique selling point. The headline statement is that *‘Jersey is a safe place to put your money’* because of its: well-regulated regime (10), professional expertise (9), legal system – especially trust law (6), tax neutrality (5) and political stability (5). Association with the United Kingdom was important (7) for a variety of reasons: geographic location, historical relationship, being within the Sterling zone, English language and Jersey was described as a distilled version of the City of London. Notably, the two firms that did not want Jersey financial services regime to seek MiFID II equivalence both cited Jersey’s well regulated regime as an attraction for clients.
- d. With respect to Jersey’s financial services regime, ‘Had they had any complications or conflicts with the EU’s regulatory regime?’ three themes emerged. Ten firms had adopted UK/MiFID I standards to fill gaps they found in Jersey’s financial services regime, or had adopted UK standards as part of group policy. Five specifically mentioned that the FS(J)L and CoP were thin on detail or lacked clarity – again several cited using the UK regime to fill in the gaps. One remarked that Jersey’s suitability guidance was *‘surprisingly short’*. Eight supported a higher degree of EU harmonisation of regulatory definitions and concepts to reduce complexity.
- e. An undercurrent that ran through many of the meetings was that in the transition to a fees based business model IB firms had raised their sights on moving into the ultra high net worth and family office markets. It became clear that many of these clients could be considered as large undertakings (per se professional investors under MiFID II). Hence, if Jersey’s financial service regime became MiFID II equivalent, IB firms would have the kite mark (and legal right) to market to the ‘old’ wealth of the EU.

Appendix B – summary of IB survey statistics

		Sample =	45	90% Confidence	95% Confidence
Q1 Does Investment Business ("IB") represent a significant part of your overall income?				1.65	1.96
				+/-	+/-
A	Yes - it represents more than 75% of my business	48.9%		8.7%	10.4%
B	Yes - it represents more than 50% of my business	11.1%		5.5%	6.5%
C	Yes - it is more than 10% of my overall business	13.3%		5.9%	7.1%
D	No - it is less than 10% of my overall business	26.7%		7.7%	9.2%
Q2 Approximately what percentage of your IB revenues comes from UK resident clients?				+/-	+/-
A	Less than 10%	55.6%		8.7%	10.3%
B	10% to 25%	24.4%		7.5%	8.9%
C	25% to 50%	15.6%		6.3%	7.5%
D	50% to 75%	4.4%		3.6%	4.3%
E	75% to 90%	0.0%		0.0%	0.0%
F	Greater than 90%	0.0%		0.0%	0.0%
Q3 Approximately what percentage of your IB revenues comes from European Union resident clients - excluding the UK?				+/-	+/-
A	Less than 10%	77.8%		7.2%	8.6%
B	10% to 25%	22.2%		7.2%	8.6%
C	25% to 50%	0.0%		0.0%	0.0%
D	50% to 75%	0.0%		0.0%	0.0%
E	75% to 90%	0.0%		0.0%	0.0%
F	Greater than 90%	0.0%		0.0%	0.0%
Q4 Do you have a branch office in the European Union ("EU")?				+/-	+/-
A	Yes	11.1%		5.5%	6.5%
B	No	88.9%		5.5%	6.5%
Q5 Are you a subsidiary of an investment firm whose headquarters are based outside Jersey?				+/-	+/-
A	Yes, my firm is a subsidiary of an EU investment firm	20.0%		7.0%	8.3%
B	Yes, my firm is a subsidiary of a non-EU investment firm	15.6%		6.3%	7.5%
C	Not applicable	64.4%		8.3%	9.9%
Q6 If you are the subsidiary of a non-EU investment firm, does your parent company have branch in the EU?				+/-	+/-
A	Yes	6.7%		4.3%	5.2%
B	No	6.7%		4.3%	5.2%
C	Not applicable	86.7%		5.9%	7.1%
Q7 Please provide us with an insight into the geographic location and classification of your clients by completing the boxes below				+/-	+/-
A	Number of Jersey resident clients - Retail	30.1%		6.8%	8.1%
B	Number of Jersey resident clients - Professional	2.1%		3.9%	4.6%
C	Number of UK resident clients - Retail	18.0%		2.4%	2.9%
D	Number of UK resident clients - Professional	0.5%		1.6%	1.9%
E	Number of other EU clients - Retail	7.2%		1.3%	1.5%
F	Number of other EU clients - Professional	0.2%		2.2%	2.6%
G	Number of RoW clients - Retail	39.6%		3.5%	4.1%
H	Number of RoW clients - Professional	2.3%		2.3%	2.8%
Q8 Looking at a summary of your 10 largest clients, please distribute those 10 clients by geographic location and type in the boxes below.				+/-	+/-
A	Jersey resident clients - Retail	45.6%		6.9%	8.2%
B	Jersey resident clients - Professional	9.5%		3.5%	4.2%
C	UK resident clients - Retail	10.0%		2.9%	3.4%
D	UK resident clients - Professional	3.6%		2.0%	2.4%
E	Other EU resident clients - Retail	2.9%		1.2%	1.4%
F	Other EU resident clients - Professional	3.6%		2.1%	2.4%
G	RoW resident clients - Retail	12.2%		3.1%	3.7%
H	RoW resident clients - Professional	12.6%		4.3%	5.2%

Appendix C – list of representative bodies who have been sent this consultation paper

- › Jersey Bankers Association
- › Jersey Compliance Officers Association
- › Jersey Consumer Council
- › Jersey Finance Limited
- › Jersey Funds Association
- › CFA UK
- › Channel Islands Financial Ombudsman
- › Chartered Institute for Securities & Investment, Channel Islands Branch
- › Personal Finance Society