DILLON EUSTACE

21 September 2016

Department of Finance public consultation on national discretions in the Markets in Financial Instruments Directive ("MiFID II") incorporating elements of the Insurance Distribution Directive ("IDD") (the "Consultation")

Dillon Eustace welcomes the opportunity to comment on the potential impact of MiFID II and the IDD in Ireland and on how Ireland should apply the EU Member State discretions contained within those directives.

In this paper, we have responded to the specific questions raised by the Department of Finance in the Consultation.

Should you have any queries on our submissions below, please do not hesitate to contact us.

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Question 1:

A: The Minister is minded to exercise the discretions provided for in Article 3(1)(a) - (c). Do you agree with this approach? If not, please outline your reasons.

Dillon Eustace agrees with the approach that the Minister should exercise the discretion provided for in Article 3(1)(a) – (c).

B: If persons described under Article 3(1)(a) – (c) are exempted from MiFID, what provisions of MiFID, in your opinion, have no corresponding domestic rules/requirements which are at least analogous, in accordance with the list set out in Article 3(2). Please specify the amended domestic rules that would be required.

As noted in the Consultation, retail investment intermediaries authorised under the Investment Intermediaries Act 1995 (the "**IIA**") are currently exempt from MiFID I. However, we would also like to highlight that entities authorised by the Central Bank of Ireland (the "**Central Bank**") pursuant to the IIA to provide fund administration services to collective investment schemes also avail of the exemption under Article 3(1) of MiFID I.

As noted in the Consultation, firms authorised under the IIA are subject to the provisions of the IIA itself, as well as certain additional requirements such as the Handbook of Prudential Requirements for Investment Intermediaries, the Central Bank's Consumer Protection Code, the Minimum Competency Code and the Central Bank's Fitness and Probity Standards, (the "**IIA Regime**").

The IIA Regime imposes conditions and procedures for the authorisation and on-going supervision of firms, conduct of business requirements and organisational requirements on such firms. In the interest of continuity, it is important that the term "at least analogous" is interpreted in a broad fashion in arriving at a conclusion that the IIA Regime approximates to the MiFID Regime so as not to merit any additional amendments to the IIA Regime which would give rise to additional implementation/operational costs but are not resulting in any meaningful investor protection (if any).

Question 2:

The Minister for Finance is strongly minded to maintain the status quo, namely to maintain the requirement that all investment firms, regardless of any exemption enjoyed by virtue of Article 3(1), should be covered by the investor compensation scheme.

Do you agree with the proposed approach? If not, can you provide justifications?

Dillon Eustace notes that MiFID II provides for flexibility so that Member States may allow investment firms not to be covered by an investor compensation scheme and instead such firms could hold professional indemnity insurance.

Dillon Eustace supports the exercise of this flexible approach through the transposition of the discretion in circumstances where investor protection is protected through the imposition of certain conditions attaching to the professional indemnity insurance such as, the term of the insurance shall have an initial term of no less than one year or the insurance policy shall have a cancellation period of at least 90 days. Similar conditions are already reflected in other legislative requirements in the funds sector.

Question 3:

A. In light of:

- **the new MiFID and IDD rules,**
- **their divergence in key respects (as outlined above),**
- **the national discretions provided therein (as outlined above), and**
- **the need for appropriate levels of protection for consumers of investment products, whoever they may deal with,**

do you consider that there should be level playing field rules in relation to the distribution of, and advice on, functionally equivalent retail investment products?

It is our view that investors should, irrespective of how they purchase investment products, be afforded a similar level of protection. Dillon Eustace submits that a consistent legislative approach should be adopted in respect of the rules relating to the sale to retail investors of functionally equivalent investment products and that the Minster ought to ensure a level playing field in this regard.

C. Which option, if any, do you think best addresses the interest of retail investors and why?

If you preference is for option 2, can you please specify whether you agree with the suggested criteria ((a) to (h)) at outlined above

Dillon Eustace submits that it is important to ensure that in advance of the Minister selecting either option proposed, that appropriate consideration and consultation is undertaken to ensure that there are no unintended consequences for authorised firms in terms of contradictory obligations or requirements and that a proportionate approach is adopted.

Question 4:

Do you agree with the Minister's proposal to continue to exercise this discretion?

Dillon Eustace agrees that the Minister should exercise his discretion such that the status quo is maintained.

Question 5:

A: The Minister is considering the policy options in relation to this national discretion. Please provide any views you may have on this issue, including supporting rationale for or against imposing a branch requirement.

We note that the UK has not sought to exercise this discretion for either retail or elective professional clients. Dillon Eustace is of the view that the Minister should undertake a detailed consultation process/review to better understand the consequences of transposing and implementing the legal framework set out in Article 39 of MiFID II which provides EU Member States with the discretion as to whether they require third-country firms who seek to provide investment services to retail or elective professional clients to set up a branch in a Member State. We would also point to the importance of ensuring that in any transposition of the Article 39 requirements, the Minister should ensure that such requirements are implemented in a manner consistent with legislative approaches taken across other financial services sectors.

B: Do you agree with that branches of third country firms should be brought within the scope of the MiFID 2 regulations? If not, please provide reasons why you do not favour this approach.

In order to ensure a level playing field and adequate investor protection, Dillon Eustace agrees with the proposed approach that branches of third country firms should be brought within the scope of the MiFID 2 regulations.

Question 8 - criminal sanctions and proposed administrative sanctions in respect of discretionary measures under MiFID II

Question 8:

8A: Do you agree with the Minister's views as outlined?

As set out in the Consultation, certain infringements of MiFID I are designated criminal offences under section 5 of the Markets in Financial Instruments and Miscellaneous Provisions Act 2007 (the "**2007 Act**"). Most of the offences relate to acting as an investment firm when not authorised to do so, advertising investment or ancillary services when not authorised as an investment firm and knowingly or recklessly providing false or misleading information to the Central Bank of Ireland (the "**Central Bank**") in general or in connection with an authorisation application (together the "**Authorisation Breaches**").

Dillon Eustace agrees that it would be appropriate for the Minister to make infringements of this nature under MiFID II criminal offences, given the gravity of such infringements. However, section 5 of the 2007 Act also designates breaches of Regulation 40(1), Regulation 109(6) and Regulation 112(1) of MiFID I criminal offences. Dillon Eustace believes that the Minister should not designate any breaches of requirements contained in MiFID II criminal offences, which are similar to those contained in Regulation 40(1), Regulation 109(6) or Regulation 112(1) of MiFID I, for the reasons explained below.

Regulation 40(1) of MiFID I provides that an investment firm must retain all records required under MiFID I for a period of 5 years. Regulation 112(1) of MiFID I also relates to records and provides that investment firms shall keep for at least 5 years records of all relevant data relating to each transaction in financial instruments executed by the relevant firm, whether on own account or on behalf of a client (it also contains certain other requirements). Article 16(6) and 16(7) of MiFID II relate to the retention by investment firms of records.

Regulation 109(6) of MiFID I relates to tied agents and provides that if an investment firm appoints a tied agent which provides services and activities not covered under MiFID I ("**Non MiFID Services**") and services and activities to which MiFID I applies, the firm shall take adequate measures to avoid any negative impact that the Non MiFID Services may have on the MiFID services, which are provided by the tied agent on behalf of the Firm. Article 29 of MiFID II relates to tied agents and Article 29(4) appears similar to Regulation 109(6) of MiFID I - it provides that Member States shall require investment firms appointing tied agents to take adequate measures to avoid any negative impact that activities of the tied agent which are not covered by MiFID II, may have on the activities carried out by the tied agent on behalf of the investment firm.

Dillon Eustace is of the view that any breaches of MiFID II by an investment firm in relation to retention of records, or in ensuring that any Non MiFID Services provided by a tied agent of the investment firm do not negatively impact the services of the tied agent provided under MiFID II (such as those contained in Articles 16(1) and Article 29(4) of MiFID II), should not be designated criminal offences.

Firstly, it is noted that Article 70(1) of MiFID II requires Member States to ensure that their competent authorities can impose administrative sanctions and measures applicable to all infringements of MiFID II or of Regulation (EU) No 600/2014. Dillon Eustace assumes therefore that the domestic legislation implementing MiFID II and Regulation (EU) No 600/2014 will be included as a "designated statutory instrument" in Schedule 2 Part 2 of the Central Bank Act 1942 (the "**1942 Act**") (as has been done with MiFID I) and accordingly will be subject to the Central Bank's Administrative Sanctions Procedure (the "**ASP**"). If an inquiry is held under the ASP and findings are made against a regulated financial service provider ("**RFSP**") or a person concerned in the management of an RFSP (a "**PCM**"), under section 33AQ of the 1942 Act the RFSP can be liable to sanctions of up to €10 million or 10% of its turnover in the last complete financial year before the finding is made and/or revocation of its authorisation (among other sanctions). The PCM can be liable for sanctions of up to €1 million and/or disqualification from being concerned in the management of a regulated financial service provider (among other sanctions). These sanctions are potentially very serious.

Dillon Eustace is of the view that it would be unduly burdensome and disproportionate to designate any breaches of obligations under MiFID II that are similar to those contained in Regulation 40(1), Regulation 109(6) and Regulation 112(1) of MiFID I criminal offences, given that these breaches will already be (presumably) sanctionable under the Central Bank's ASP regime. Dillon Eustace considers that the potentially very significant penalties available under the ASP regime as described above, should provide sufficient deterrence to encourage compliance and the addition of potential criminal sanctions is not necessary or proportional.

In the alternative, if the Minister is not persuaded by the argument that the threat of sanction under the ASP is sufficient deterrence, Dillon Eustace submits that any regulatory breaches under MiFID II similar to those contained in Regulation 40(1), Regulation 109(6) and Regulation 112(1) of MiFID I should only constitute criminal offences if they are committed "*knowingly or recklessly*" by an individual and/or the firm. Although in MiFID I most of the Authorisation Breaches refer to the breach being committed "*knowingly or recklessly*", there is no similar pre-requisite for the breaches under Regulation 40(1), Regulation 109(6) and Regulation 112(1) of MiFID I. Dillon Eustace submits that, at a minimum, a pre-requisite of any such offence should be that it was committed "*knowingly or recklessly*". Dillon Eustace believes the need of such a pre-requisite is particularly strong where a responsibility is created on the part of the investment firm in respect of a third party.

8B: Do you agree with the Minister's views as outlined?

Dillon Eustace has no comments on the Minister's proposal to align the maximum level of administrative fine for a legal person to €10 million, as it notes that this will bring it in line with the maximum fines provided for legal persons in the 1942 Act, as amended by the Central Bank (Supervision and Enforcement) Act 2013.

Dillon Eustace agrees that the Minister should not increase the maximum fines for natural persons to above €5 million (this is already an extremely punitive sum) and that the Minister should not increase the disgorgement amount beyond twice the amount of the benefit derived from the infringement, where that benefit can be determined.