

European Securities and Markets Authority Consultation Paper on MiFID II/MIFIR

The Chartered Accountants Regulatory Board (CARB) was established in 2007, under the Bye-laws of the Institute of Chartered Accountants in Ireland (the Institute), to regulate Institute members and member firms independently, transparently and in the public interest.

CARB welcomes the opportunity to comment on this Consultation Paper issued by The European Securities and Markets Authority (ESMA). We have been pleased to engage with the Institute of Chartered Accountants in England and Wales (ICAEW) and the Institute of Chartered Accountants of Scotland (ICAS) in the drafting of this response and in forming the opinions expressed therein.

We have limited our response to question 1 of the Consultation Paper concerning the interpretation of “incidental” as this is of significant importance to our members licensed to provide investment activities pursuant to Part XX of the Financial Services and Markets Act 2000. CARB is recognised as a Designated Professional Body (DPB) for the purposes of the Part XX regime. As CARB, ICAEW and ICAS share a DPB Handbook and have concerns in common we are submitting similar responses. The CARB response is outlined below.

Q1. Do you agree with the proposed cumulative conditions to be fulfilled in order for an investment service to be deemed to be provided in an incidental manner?

No we do not agree.

The Institutes (CARB, ICAEW and ICAS) are designated professional bodies under Part XX of the Financial Services and Markets Act 2000 (the Act). This enables us to provide arrangements through which our firms may take advantage of an exemption from the general prohibition on carrying on activities that are regulated under the Act, thus dispensing with the need for authorisation from the Financial Conduct Authority (FCA).

Section 327 of the Act details certain conditions which firms must meet to take advantage of the exemption from the general prohibition. These conditions include the requirement that the services provided must be incidental to the provision of professional services. The FCA has issued guidance on what it considers to be incidental in its Professional Firms Sourcebook. Similarly, we have included in our rules for the designated professional body scheme (the DPB Handbook) guidance on what is incidental. The DPB Handbook is approved by the FCA.

So we have well established guidance on incidental issued not only by ourselves as the direct regulator of our firms, but also by the FCA. Our firms are obviously well used to this guidance since our DPB arrangements have been in place since 2002. Any change in the nature of the incidental test would therefore have an impact on the entire population of our DPB firms, and there is a significant difference between the test which is proposed and our current parameters for incidental.

We have explained below our comments in relation to each aspect of the proposed test:

i. a close and factual connection exists, including in temporal terms, between the professional activity and the provision of the investment service to the same client, such that the investment service is regarded as accessory to the main professional activity; and

The proposed new test in i appears much stricter than that which we currently apply and suggests a direct causal link between the services provided.

Under our DPB arrangements, the exempt regulated activity may be the first service provided to a client, with professional services being provided at a later date. Or there may be a time lag between the professional service and the exempt regulated activity. The Financial Services and Markets Act 2000 (Financial Promotions) Order 2005 provides a specific exemption to allow DPB licensed firms to make unsolicited real-time promotions to their clients. This promotional activity could take place sometime after the initial professional service was provided and therefore any exempt regulated activity could be provided at a much later date. Therefore existing UK law does not seek to restrict the provision of exempt regulated activities to a discrete time window.

In our view this would lead to a fundamental change in approach in the interpretation of incidental.

It is also our view that the approach set out in the proposed incidental test will not restrict the services that may be offered. By concentrating on the connection between the service provision and the professional service, no reference is made to the nature of the service which the firm may provide. It is worth noting that under our DPB arrangements, our firms may only provide a limited range of investment services, which focus on those services which are lower risk and therefore have a reduced risk of consumer detriment. We would suggest that by focussing on the timing rather than the nature of the service you will not necessarily improve consumer protection.

By way of example, many of our DPB licensed firms have only restricted involvement in investment services in relation to introducing clients to an authorised 'Permitted Third Parties' (i.e. financial advisors) and explaining the advice given to their clients, identifying unsuitable advice, but are not allowed to provide alternative advice. These are low risk activities as the client is being serviced by an authorised investment services firm which is required to comply with MiFID. There is little risk of any consumer detriment in relation to the work of our professional firm in these circumstances. However, applying the proposed test, if there is no causal link between this activity and the professional service, then this activity cannot be conducted.

It does not make sense that this revised definition would prohibit the low risk activity above but would allow more risky investment services where there is a timing and factual connection.

ii. the provision of investment services to the clients of the main professional activity does not aim to provide a systematic source of income; and

The test for incidency included in section 327 of the Act, include a provision relating to income. That test is:

"..... must not receive from a person other than his client any pecuniary reward or other advantage, for which he does not account to his client, arising out of his carrying on of any of the activities.

In our DPB Handbook, we offer further guidance on accounting for commission. It is apparent from section 327 of the Act that UK law places no restrictions on the income which may be received from incidental investment activities, whether by frequency or by the quantum.

It is entirely possible that a firm may currently offer a service which provides a systemic source of income via periodic reviews such as financial “health” checks, or may receive periodic commission, which the client allows the firm to keep, for referring a client elsewhere.

It appears therefore that our current arrangements would conflict with the test in ii.

iii. the person providing the professional activity does not market or otherwise promote his/her availability to provide investment services.

At a basic level we require firms to disclose their status as a DPB licensed firm and to describe the activities they are able to carry out. Most firms meet this requirement by using a legend as part of their letterhead. In our view this disclosure is helpful. Whilst this is not marketing, firms are making it clear to clients that they are able to provide investment services and may therefore fall foul of the test “or otherwise promote” in iii.

Also, as part of our DPB licensing arrangements, firms may, in certain limited circumstances make financial promotions. Such activities are facilitated by exemptions in the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005. So the UK law enables our firms to promote their investment services and products and in this regard, the law appears to be in conflict with the test in iii.

At paragraph 11, the consultation talks about restricting the investment services provided by professionals “that are not authorised and supervised as investment firms under MiFID, and therefore are not subject to the relevant MiFID organisational and conduct of business requirements aimed at ensuring an adequate level of protection to investors.”

We would challenge the premise that our current arrangements do not adequately protect investors. Part XX of the Act enables members of the professions to provide financial services only if they are subject to the rules of a designated professional body. The memoranda of understanding which all DPBs have agreed with the FCA states that the overriding objective of Part XX is the provision of an appropriate level of protection for clients. It must therefore be concluded that by being designated by the FCA that the Institutes’ arrangements provide a level of protection for clients which is acceptable to the UK government and is therefore adequate.

As Members of a professional body, our Members have stringent entrance requirements, including examination and fit and proper requirements. Once admitted Members are required to maintain their fitness and propriety, satisfy continuing professional development requirements, and abide by a strict code of ethics. The firms in which our Members operate are also required to keep sufficient professional indemnity insurance (PII) and are subject to significant monitoring requirements, including desk top monitoring of annual returns and on-site inspections. Any complaints from clients are dealt with through PII and the Institutes will investigate complaints made to them about their Members. We would therefore argue that accountancy bodies impose significant requirements upon their members which ensure that our accountants act in their clients’ best interests and that investor protection is achieved.

Our experience of operating DPB arrangements for some 12 years is that this aspect of our firms’ practices are very low risk and generate few if any complaints from the users of their services. This

provides us with further evidence that the level of protection for clients in our arrangements is adequate.

As we stated initially the incidental test is one of the basic building blocks of our arrangements under Part XX and forms an integral part of our firms' understanding of the operation of our DPB arrangements. That incidental test is subject to approval by the FCA and is closely aligned to the guidance in the FCA's Professional Firms Sourcebook. We also draw on the Financial Services and Markets Act 2000 and the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005 as a basis for that test and other aspects of our DPB arrangements. As previously noted above, the new test proposed appears to be in conflict with existing UK law.

Any change would therefore have a direct impact on the 2,812 firms which the three Institutes license collectively. Those firms would undoubtedly have to amend their business practices which will incur costs and may cause some firms to exit the market.

If you require further information on this response, please do not hesitate to contact Noelene Steele, Head of Governance and Risk at Noelene.Steele@carb.ie