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Financial Services Authority

Inter-Professional Conduct

Feedback on CP47

Supplementary consultation on
Training and Competence arrangements
for section 43 dealers and brokers

February 2001



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This paper reports on the main issues arising from Consultation Paper 47: The Inter-Professionals Code. It contains the 'final' IPC chapter. It also sets out for consultation a proposal on a transition arrangement for the Training and Competence regime for section 43 dealers and brokers. The IPC has been approved by our Board and will be legally made when we assume our rule-making powers. A few minor amendments may then be necessary to take account of changes in other areas such as Handbook definitions.

The closing date for responses to the consultation on section 43 dealers and brokers is 4 May 2001. Comments may be sent by electronic submission using the form on the FSA's website (at www.fsa.gov.uk/pubs/cp/cp83_response.html).

Alternatively, please send comments in writing to:

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It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise.

1 Executive summary

1. We published Consultation Paper 47: The Inter-Professionals Code, in May 2000. This sets out our proposals for the standards expected of authorised firms when they undertake dealing and arranging and give associated advice on a wide range of investments with a market counterparty. This will form a chapter of the Market Conduct Sourcebook within the FSA's Handbook of Rules and Guidance and be renamed Inter-Professional Conduct (IPC).
2. We received 45 responses to CP47 from authorised and exempted firms, professional advisors and trade associations and are grateful to all the parties that responded. This paper gives feedback on the issues raised in the responses and on how they have shaped the ongoing development of the IPC. A revised IPC is included as Annex C.
3. There has continued to be general support for the underlying principles behind the IPC; that some fleshing out of the Principles in this area is desirable; that inter-professional business is largely self disciplining; and that the level of supervision applied should be appropriate to the risks to our statutory objectives. There was support too for the policy objectives of the scope and content of the IPC. This paper explains that both remain largely unchanged and the focus has been on ensuring clarity of application, especially in relation to other parts of the Handbook. There have, however, been amendments to the rules and guidance on non-market-price transactions and it has been decided that corporate finance activity should be excluded from the scope of the IPC.
4. The IPC is aimed primarily at promoting market confidence and is written on the basis that the users of the document will be market professionals. It will, however, also be relevant to the FSA's other objectives. In particular we believe that, in the context of the scope of the IPC, the best protection for consumers is in the maintenance of market confidence and standards of market conduct.

5. We also set out a consultation proposal on a transition arrangement for the Training and Competence regime for section 43 dealers and brokers. The section 43 regime ends at N2 (when the legislation will come into force), as does that of the Self Regulatory Organisations, and these proposals concern the length and nature of the transition. The main proposal is that the status quo is maintained for a period of two years after N2, so that more detailed proposals may be considered.

2 Responses to CP47

Structure and application

1. There was general support for the underlying principles behind the IPC:
 - the level of supervision of inter-professional business should be appropriate having regard to the degree of risk to our statutory objectives;
 - inter-professional business will in many ways be self-disciplining;
 - the articulation of the Principles through guidance (and some rules) will provide more certainty for firms than having the Principles alone in this area of business; and
 - it is unlikely that isolated departures from the guidance set out in the IPC would warrant enforcement action, although this would depend on the nature and impact on the market of the activity carried out.

A small number of respondents continue to express the view that the guidance in the IPC is unnecessary for dealings between professionals, and who favour disapplication of inappropriate COBS rules without any further articulation.

The FSA's response: The large majority of respondents, including the trade associations, support the rationale for the IPC, which was designed to reflect earlier rounds of consultation. The guidance in the IPC was by and large welcomed by respondents. We have, however, made every effort to keep the requirements in the IPC to a minimum and the document as brief as possible.

2. There was concern that the title of Inter-Professionals Code was potentially confusing, in that the document is not a 'code' within the meaning of the Act and consequently this could cause confusion with the Code of Market Conduct and the Approved Persons Code.

The FSA's response: We accept that there is a risk of confusion and will rename this chapter 'Inter-Professional Conduct'. It will continue to be referred to throughout this paper as the IPC and is still Chapter 3 in the Market Conduct Sourcebook within the FSA's Handbook of Rules and Guidance.

3. The application of the IPC was generally felt to be clearly expressed and there was broad support for its scope. There was felt to be a need for guidance on what regulatory requirements related to activities and products specifically excluded from the IPC. There was though particular concern about the need for greater clarity on the join with COBS. Some respondents wanted corporate finance to be included in the IPC, due to the need for a 'light touch' form of regulation; it is not included within the IPC and will appear in COBS (see paragraph 15).

The FSA's response: We acknowledge that there was a lack of clarity as regards the join with COBS. The Statement of Policy for COBS, issued in January 2001, gives feedback on the consultation, in CP57, on the client classification rules and associated definitions. This Statement seeks to address the points raised in the drafting of the rules and the relevant definitions. There are four main changes:

- First, we have changed the market counterparty definition to make clear that clients (other than authorised firms) classified as market counterparties will retain this status for IPC and non-IPC business. For non-IPC business the non-customer related Principles will apply to dealings between the market counterparty and the firm;
- Second, the position for authorised firms is different. When a firm carries out non-IPC business and has an underlying customer, it must deal under COBS (i.e. as an intermediate customer). However, a firm dealing for its own account, without an underlying customer, must conduct non-IPC business as a market counterparty and the non-customer related Principles will apply;
- Third, the opt up provisions for intermediate customers moving to market counterparty status (COB 4.1.10) have been changed to allow one-way notifications to bodies corporate. This aims to balance the existing section 43 and SFA wholesale market regimes (respectively more and less liberal), without unduly prejudicing the consumer protections that FSA believes are necessary for clients opting-up. Firms will be required to give written notice to these customers, state that regulatory protections will be lost and ensure that notices are given to a person competent to deal with them; and
- Fourth, the client definition has been changed to deal with the position of appointed representatives. In addition, exclusions have been incorporated for corporate finance and venture capital business, and trust beneficiaries. These take forward existing provisions in the FSA and IMRO rules.

There is more guidance on the scope of application in Annex 1 of the IPC. There was some concern that Annex 2 of the IPC, which sets out the relevant provisions of COBS, could be misleading if it could not be made to cover all of the provisions in the Handbook. We recognise this concern, but feel that it is worth persevering with the section, which should mirror similar aides to navigation within COBS.

4. The geographical scope of the IPC gave rise to some comment, especially the application to groups that carry out investment business abroad and then book the transactions through an entity in the United Kingdom. The general view was that it was inappropriate for the IPC to apply to such dealings, especially as there was scope for overlap, and even conflict, with the conduct of business requirements of the jurisdiction where the business is undertaken.

The FSA's response: The position has been restated in the guidance in Annex 1. Where the transaction is booked back through a UK office, that firm is considered to be dealing and the IPC does apply. Whilst this does in theory suggest scope for conflict between regulatory jurisdictions, we do not believe that, in practice, such conflict will be significant or unmanageable. The application of such regulatory requirements are part of the ongoing debate on the reform of the Investment Services Directive. The geographical application of the Principles and other parts of the Handbook are not, in all cases, the same as that of the IPC and firms will need to be aware of the relevant requirements.

5. The proposal to include 'good practice material' in Annex 3 in the form of informational guidance is a novel addition for the Handbook, but one we felt appropriate given the nature of the material and the purpose of the IPC. Most responses to the consultation agreed with this approach, several pointing out that the advice it contains is as appropriate for market counterparties as for the firms dealing with them. We are keeping this annex as part of the chapter (as the responses preferred) and are happy to make this point about the general applicability of the material. There have been some additions to the material, which are discussed below at paragraphs 16 and 17. The revised text clarifies that the annex, which is guidance under section 157(1)(d) of the Act; it is not guidance on rules.

Content

6. Most of the content of the draft IPC was uncontroversial. The main concerns related to the structure (see above paragraph 1) and the relationship to other documents, both within the Handbook (see above paragraph 3) and externally (see below paragraph 14). The majority of comments on content concerned the section on non-market-price transactions (see below paragraph 9). So, the version of the IPC attached at annex C is relatively unchanged in terms of its underlying policy objectives. Because there is no significant change in policy, the Cost Benefit Analysis and Compatibility Statement prepared with CP47 are still relevant to this paper. The main changes in the IPC relate to our aim to ensure that the document is concise, logically set out and readable, bearing in mind that it has to fit within the standards and protocols for our Handbook as a whole.

Firmness of quotation

7. Guidance on the firmness of quotation was thought to be appropriate for most markets. However, given the application of the IPC to a wider range of markets than the scope of the London Code, there was some concern that this guidance might not always be suitable. Consequently, a number of responses suggested that this section would more usefully form part of the 'good practice material' in Annex 3.

The FSA's response: The guidance on firmness of quotation has largely been retained, and the section placed in the 'good practice material' in Annex 3 in line with what seems to be general preference.

Marketing, inducements and entertainment

8. The objectives of the guidance on marketing, inducements and entertainment are twofold. First, to ensure that inducements offered or received are proper and will not conflict with any duty or obligation by the recipient. Second, to avoid any hidden conflicts of interest, which might arise in the area of commissions, by ensuring transparency. This guidance was felt to be in sympathy with current market practice. There was thought to be some scope for confusion as to the relationship between the IPC provisions and those in COB 2.2. This is where a firm deals with a market counterparty such as a fund manager who has his own customers.

The FSA's response: Both the IPC and COBS have been amended to clarify the position where there are underlying customers. So, whether the firm is dealing with a market counterparty or a customer, the provisions in COB apply to the firm. This is the case even when the firm does not know the actual identity of the customers. The rule in COB 2.2.3 does, however, provide relief for those instances where a firm deals with a market counterparty and would not reasonably know that there are underlying customers. For example, where a firm deals with a fund manager, it would do so clearly on the understanding that there are customers involved. But in principal to principal dealings, the COBS provisions would not be relevant. The issue here is primarily for current SFA firms, who may deal in more than one capacity.

Non-Market-Price Transactions

9. There was general agreement with the basis of the policy on Non-Market-Price Transactions (NMPTs). These transactions should not be used to hide losses or profits, or transfer an inter-professional investment at under or over value, in order to misrepresent a firm's or a market counterparty's books and records. There was, however, some concern that the drafting in the Consultation Paper did not necessarily achieve those policy objectives due to the difficulties in defining the boundary between acceptable and unacceptable transactions. There was concern that whole classes of transactions would fit

the definition of NMPTs and need an exhaustive, deal by deal, process to ensure that the purpose behind them was not improper. The rule we drafted attempted to deal with the situation where market price was difficult to identify; there was some concern that this was not adequately achieved and the rule could be used to encroach upon legitimate profits. Further, there was broad agreement that the requirements should focus on the parties actually dealing, whether as principal or agent. There should be a lesser requirement upon brokers or other arrangers, who inevitably would have a more limited role in the transaction. There was a general consensus that the requirements on NMPTs should extend to firms' dealings with intermediate customers, reflecting the present coverage in the London Code and indeed the main target of the NMPT provisions.

The FSA's response: The section on NMPTs was the most complex part of the IPC and it is not surprising that it received the most comment and the most redrafting. The guidance has been re-ordered and rewritten to make clear the two stages of identifying a transaction not at market price, followed by the assessment of the purpose behind it. The evidential provisions allow for a shorter procedure to apply where whole classes of transactions might routinely be identified as appearing to be for an improper purpose. With this revised framework, the FSA believes that the proposed rule is still a fair representation of our objectives and, although its structure has been simplified, its core remains unaltered.

The rule has been disappplied for arrangers. However, as pointed out in the guidance, they still have a duty under the Principles not to take part in a transaction that they know to be improper. This is a continuation of London Code policy and is appropriate because arrangers in many cases may not know whether an NMPT has been carried out (if they are involved with only part of the deal) and will not know the participants' motivation. But arrangers clearly should not instigate NMPTs that they know to be improper.

In the case of firms' dealings with intermediate customers, COBS has mirrored the IPC's rule at COB 7.16 and has referred to the guidance in the IPC; this has had the effect of fully carrying over these requirements.

Taping

10. There was little comment on the provisions on taping in the consultation paper and the drafting is largely unchanged. The rule tying in the keeping of voice recordings to the record-keeping requirements (at 2.9.4R in the consultation version) has been deleted. This covered using voice recordings to meet the record-keeping requirement. This requirement is now included within existing record-keeping requirements elsewhere in the Handbook; the deletion of this particular rule from the IPC does not mean any change in policy.

11. The previous consultation discussed the implementation of Article 5 of the Telecoms Data Protection Directive. Since then, the DTI has carried out its own consultation process. Their Regulations¹ allow for interception of telephone communication where it is to ascertain compliance with regulatory practices, procedures, rules and guidelines. We consider that firms taping front and back office telephone lines in accordance with the IPC, and provided they can show they do so in line with the IPC, are able to rely on this provision in the Regulations. Firms are, however, advised to consider the Regulations in full.

Provisions for brokers and those undertaking transactions through them

12. Several of the responses in the consultation comment on the confusion arising from the use of terms relating to brokers and arrangers. In response, we have amended the text: the generic term of 'wholesale market broker' has been introduced and this covers both name-passing and matched principal brokers. There will clearly be arranging activities carried out other than by persons calling themselves wholesale market brokers; so where necessary, we refer to arrangers or name-passing brokers, the latter being a term used by those operating as arrangers in certain traded markets.
13. The WMBA expressed concern about the section on settlement of differences, where the rationale behind the provisions now located in MAR 3.7.6G to 3.7.8G appeared unclear. The main change between the previous consultation and the present guidance is in the paragraph MAR 3.7.7G. This makes it clearer that the guidance on how parties should act if a price is missed applies to both the broker and his client. Because accepting the liability for a difference is legally and economically equivalent to taking a position, any broker does so would run against the guidance on clarity of role. His client, the firm acting as principal or agent, should complete the transaction at the next available price. This is because it is the basis on which the broker is known to be acting and also because of the implications for the smooth running of the market if he was to do otherwise.

Codes of practice and annexes

14. There was a range of responses to the question on the relationship between the IPC and industry codes of practice and the possibility of inclusion of annexes for specific markets within the IPC. Some market participants were uncertain of the relationship between the IPC and the NIPs Code, an industry code being prepared under the auspices of the Bank of England's FX Joint Standing Committee, after extensive consultation with the market. They were

¹ The Telecommunications (Lawful Business Practice) (Interception of Communications) Regulations 2000.

also nervous about how to deal with any conflicting requirements between the two. There was little demand for the inclusion of specifically written industry annexes, although there were suggestions that we might endorse and possibly reproduce certain established codes of practice with the IPC. There was also a suggestion that we might look at good practice in the area of corporate actions in equity markets.

The FSA's response: The Act expressly limits the FSA's powers to endorse third party codes to that issued by the Takeover Panel. The relationship between the FSA and industry codes of practice is set out in the Threshold Conditions, published in August 2000 with CP63: The Authorisation Manual (see COND X.8.6G(4)). Mention of this in the IPC is for ease of reference only.

We recognise that the relationship to the NIPs Code is of particular importance to many market participants and hope that the position has become clearer with its publication by the Bank of England for consultation in November 2000. The NIPs code will be reviewed by the three practitioner groups that produced it, in the light of the response to the consultation and the final version of the IPC. The differences between the two documents have been significantly reduced and it is for those who produced the NIPs code to decide whether they, as practitioners, believe that different standards are appropriate for the markets in which they operate. As the IPC and the NIPs Code are currently drafted, they do not impose any conflicting requirements, although there do contain differing standards in some areas. We recognise the current reluctance to address the issue of specific industry annexes and do not propose to force the pace of this issue. The current opposition may in part reflect the current rate of regulatory publications and it may be appropriate to revisit it once the Handbook has been issued in full.

Corporate Finance

15. The consultation asked for views on the treatment of corporate finance, where the activity involves dealing and arranging and related advice for market counterparties. The treatment of corporate finance activity where the client is a customer is set out in COBS and the issue is whether such business should be in COBS or in the IPC when conducted with a market counterparty. Similar questions were raised for venture capital business. Responses on this issue were mixed. A number of responses thought that the correct domicile for this business should be the IPC, based on their view that it should be subject to 'light touch' regulation. Others, however, thought that the advisory nature of corporate finance activity was inappropriate for the IPC and pointed out that the IPC did not address the requirements of corporate finance activity and would need some changes to do so.

The FSA's response: Bearing in mind the present treatment under SFA rules, and the consequent simplicity of maintaining the status quo, we will exclude corporate finance business from the IPC and keep the requirements on firms carrying out corporate finance activities in COBS. As a corollary, the requirements on venture capital firms are also in COBS.

Items omitted from the IPC at consultation

16. The consultation sought views on items that were excluded from the IPC, principally the mediation service offered under the London Code and the guidance that brokerage should be paid promptly. There was general support for omitting these items from the main body of the IPC. However, it was suggested that we should highlight the alternatives available to mediation. In addition, the broking community made strong recommendations that the provisions on payment of brokerage be kept.

The FSA's response: Provisions relating to both these issues have been added to the good practice material in Annex 3 of the IPC. In relation to the alternatives to mediation, we have considered listing the various agencies providing arbitration services. However, we decided that such a list could never be exhaustive and have limited the guidance to a statement on resolving disputes by using arbitration or mediation services.

We have had extensive discussions with the WMBA and the IPC Practitioner Group on the question of late payment of brokerage. On the basis of the role played by such firms in the promotion of orderly markets, we have agreed to the WMBA representations that such provisions should be in the good practice material (see Annex 3 of the IPC, paragraph 28).

2 Transition provisions

1. CP47 made no proposals on transitional arrangements and there was little strong opinion in the responses, other than a general wish for them to be realistic. The transitional provisions for the IPC are inextricably linked to those for client classification and COBS. These have yet to be developed in full and there are some complex issues to be addressed. We intend to consult on these in due course.
2. Two issues have been raised as needing transition provisions within the IPC. The first concern arises from the customer classification transition provisions under which all clients of section 43 brokers will be deemed to be market counterparties until the firm reclassifies its clients on a 'transition day'. Clients who, at the 'transition day', will be classified as intermediate customers will, up to that point, not benefit from the appropriate protections in COBS. We intend to address this by allowing certain provisions of the London Code to continue for those customers during the interim period.
3. The second issue is in respect of transactions which take place before the introduction of the IPC, but where the dispute arises after that date. We intend to allow for the continued application of our existing arbitration service under the London Code in such circumstances.

3 Section 43 dealers and brokers and the Training and Competence sourcebook

Context

1. At present, SFA registered dealers and s43 exempted dealers and brokers have different Training and Competence requirements. In the context of this paper, dealers are individuals that trade either on their firm's own account, for a third party or both. Both types of dealer are required to be competent but the SFA currently require registered dealers to take the Registered Persons examination before they engage in the activity. There is no similar examination requirement for s43 dealers and brokers.
2. The London Code of Conduct gives a statement on the competence requirement which currently operates for s43 dealers. Firms are responsible for the actions of their staff and so they must 'ensure that employees are adequately trained in the practices of the markets in which they deal/broke; and are aware of their own, and their firm's responsibilities. Inexperienced dealers should not rely on a broker, for instance, to fill gaps in their training or experience; to do so is clearly not the broker's responsibility' (paragraph 16 of the London Code).
3. The bringing together of all prior regulators into the FSA means that this anomaly is hard to justify. In Training and Competence terms, both types of dealer and broker are engaging in similar activities, albeit (in some cases) with a different product base, and their role makes approximate demands on them. Some are dealing only with what will be classified in the new regime as market counterparties. However, a proportion of s43 dealers and brokers deal with what will in future be classified as customers.
4. Our discussions with firms and practitioner panels suggest that more work needs to be done in this market to determine precisely how much of the Training and Competence requirement ought to apply to s43 dealers and brokers. This brief paper suggests how consultation might be carried out and seeks responses from firms both initially (in the first stage) and after the introduction of the Financial Services and Markets Act.

The proposal

5. The solution that we propose for this first stage is that the rules for s43 dealers and brokers are kept for a set period – say two years after the day on which the FSA Handbook will replace the rules of prior regulators. (See the draft transitional provision in Annex A.) Under this proposal, s43 dealers, brokers and their firms would be brought only into chapter one – the Commitments – of the sourcebook at N2. These comprise high level guidance which supports Principle 3. Under this Principle, firms must take reasonable care to organise and control their affairs responsibly and effectively. This includes making proper arrangements for any person associated with a regulated activity carried on by the firm to achieve, maintain and supervise competence. The Commitments are reproduced in Annex A. Where firms have fully complied with the London Code in respect of competent staff, firms need take no more action in respect of the Commitments.
6. The Commitments do not extend the obligations on firms in respect of the competence of their employees, as currently stated in the London Code. So we are of the view therefore that any costs which may be incurred by this proposal are only of minimal significance.
7. The question to firms about this proposal is as follows:

Would a transitional arrangement which brings s43 dealers and brokers into chapter one of the Training and Competence sourcebook only, and so maintains the current competence requirement for a defined period, be appropriate?
8. The response to this question will inform the treatment of these individuals, within the Training and Competence sourcebook, as from the commencement date. The consultation period for this first stage ends on 4 May 2001.

The second stage of consultation (after the commencement of the Financial Services and Markets Act)

9. During this second stage, while dealers and brokers remain within the commitments for the two year period after the commencement date, there will be further consultation. In particular more information will be sought on the size of the population and on the suitability of existing examinations.

The s43 population

10. The size of the population of dealers and brokers employed on s43 business has been estimated at approximately 10,000 employees [source: FSA survey 1998]. A proportion of these dealers will be within the Training and Competence scheme already, either because they cross over into SFA work or

because their employer requires that all their dealers and brokers follow an SFA route to competence.

11. Also, some dealers and brokers voluntarily take SFA examinations or exams such as those set by the ACI – the Financial Markets Association or the Wholesale Markets Brokers' Association for their own professional development. The majority of s43 dealers and brokers that have not followed an examination route to competence deal only with wholesale counterparties, which include (for Training and Competence purposes) what will be both market counterparties and intermediate customers.
12. For SFA registered dealers and brokers, the new Training and Competence sourcebook provides a lighter touch where trading is for market counterparties and intermediates. Only the rules on attaining competence and maintaining competence apply to these. The additional weight of detailed rules and guidance on recruitment, training and supervision fall only onto employees who engage with private customers. We would wish this approach to be maintained should, at a later stage, all dealers and brokers fall within the second part of the sourcebook.
13. The second stage of consultation will develop detailed options for the firms who currently employ s43 dealers and brokers to consider.

Training and Competence extract from sourcebook and transition provisions

The following is an extract from chapter 1 of the Training and Competence sourcebook and does not restate all the clauses in chapter 1. The full text can be seen in Annex C to the Policy Statement 60 – Feedback Statement to CP60: Training and Competence Sourcebook – published December 2000.

1.1 Application and Purpose

1.1.1G The **guidance** in this chapter lists some general, high level, commitments which every **firm** should make and fulfil....

1.2 Commitments

1.2.1G The **firm's** commitments to training and competence should be that:

- (1) its **employees** are **competent**;
- (2) its employees remain **competent** for the work they do;
- (3) its **employees** are appropriately supervised;
- (4) its **employees'** competence is regularly reviewed; and
- (5) the level of competence is appropriate to the nature of the **business**.

The proposed Transitional provision for the Training and Competence sourcebook (see Annex B of Policy Statement 60)

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Effective dates of transitional provision	Commencement date
	TC 2		The provisions in column (2) for twenty four months after the commencement date do not apply to a firm in respect of regulated activities carried on by the firm as a listed institution under section 43 of the Financial Services Act 1986 for which it was exempted under the Financial Services Act 1986 immediately before the commencement date.		The commencement date plus 24 months.

If this proposed transitional provision was to be adopted, the effect would be that s43 dealers and brokers would not be subject to chapter 2 of the Training and Competence sourcebook for the specified period.

List of non-confidential respondents to consultation

American Financial Services Association

The Association of Corporate Treasurers

The Association of Friendly Societies

The Association of Private Client Investment Managers and Stockbrokers

The Association of Solicitor Investment Managers

Association of Unit Trusts and Investment Funds

Barclays Group

Boyd & Associates

Britannia Building Society

British Bankers' Association¹

British Venture Capital Association

City of London Law Society

Company Law Committee of the Law Society

Credit Suisse First Boston

Cripps Harries Hall

Commonwealth Bank of Australia

Deutsche Bank AG

Fidelity Investment Services Ltd

The Fund Managers Association

¹ BBA and LIBA responded in a joint paper.

The Futures and Options Association
GFI Holdings Ltd
Halifax plc
HSBC
ISDA
Law Society of Scotland
Lloyds TSB
London Bullion Market Association
London Investment Banking Association¹
London Stock Exchange
The National Consumer Council
Morgan Stanley Dean Witter
Northern Rock plc
Office of Fair Trading
Prebon Marshall Yamane (UK) Ltd
PriceWaterhouse Coopers
Quilter & Co Ltd
Robert Fleming Group of Companies
Seaway Insurance Consultants
The Securities Institute
Standard Chartered Bank
Swiss Life (United Kingdom)
The Wholesale Markets Brokers' Association
Tradepoint
Tradition (UK) Ltd
UBS Warburg
Virgin Direct Personal Financial Service Ltd

¹ BBA and LIBA responded in a joint paper.

Draft Inter-Professional Conduct text

The following draft rules and guidance will comprise a chapter within the Market Conduct Sourcebook within Block 2 of the FSA's Handbook of Rules and Guidance.

Rules are identified by the letter 'R' (or in the case of rules having effect as evidential provisions as described in section 149 of the Act, by the letter 'E'); guidance is identified by the letter 'G'.

3 INTER-PROFESSIONAL CONDUCT

3.1 Application

APPLICATION – WHO?

3.1.1 R This chapter applies to every *firm* except that it does not apply to:

- (1) *service companies*; or
- (2) *non-directive friendly societies*; or
- (3) *non-directive insurers*; or
- (4) *UCITS qualifiers*.

APPLICATION – WHAT?

3.1.2 R This chapter applies to a *firm*:

- (1) when it carries on:
 - (a) *regulated activities*; or
 - (b) related *ancillary activities*;
- (2) to the extent that the relevant *regulated activity* the *firm* is carrying on is:
 - (a) *dealing*; or
 - (b) acting as an *arranger* (or *name-passing broker*) or agreeing to do so; or
 - (c) giving *transaction-specific advice* or agreeing to do so;
- (3) but only if the *regulated activity* referred to in (1) and (2) is in or is in respect of *an inter-professional investment* and is undertaken with or for a *market counterparty*.

3.1.3 R This chapter does not apply to the carrying on of the following activities:

- (1) the approval by a *firm* of the contents of a *financial promotion*; or
- (2) activities carried on between *operators*, or between *operators* and trustees, of the same *collective investment scheme* (when acting in those capacities); or

- (4) the **regulated activities** of safekeeping and administration of assets or agreeing to carry on that **activity**.

APPLICATION – WHERE?

- 3.1.4 R This chapter applies to a **firm's inter-professional business** carried on from an establishment maintained by the **firm** in the **United Kingdom**.

3.2 Purpose

- 3.2.1 G The main objective of this chapter (**MAR 3**) is the maintenance of confidence in the financial system, although it is also relevant to the **FSA's** other statutory objectives under the **Act**. However, many of its provisions relate to the conduct of bilateral dealings and it seeks to secure good market practice by **firms** undertaking **inter-professional business** in three ways:
- (1) by increasing certainty by explaining how the **Principles** apply to **inter-professional business**, whilst acknowledging that what is required to meet the proper standards of conduct for a **firm** may differ depending on whether or not the **firm** is dealing with a **market counterparty** (see **PRIN**);
 - (2) by setting out **rules** for **inter-professional business** in cases when it is not appropriate to rely on the **Principles** alone; and
 - (3) by setting out the **FSA's** understanding of certain market practices and conventions; drawing this information together in this way will assist certainty, reduce the scope for disputes and make it easier to resolve disputes that do arise.

3.3 Contents and status of this chapter

- 3.3.1 G **MAR 3** Ann 1G provides **guidance** on the scope of this chapter.
- 3.3.2 G **MAR 3** is not the only chapter of the **Handbook** that applies to **firms** doing **inter-professional business**. **Firms** should always consider what other parts of the **Handbook** may apply to them. A table listing the applicable **Principles** is set out in **MAR 3** Ann 2G. The table also sets out the key provisions of **COB** that may also apply to **firms** doing **inter-professional business**, but it should not be read as an exhaustive list. **Firms** should also consider the other provisions of the **Handbook**, especially but not exclusively **ML** and **PRU**.
- 3.3.3 G **MAR 3** Ann 3G is a statement of what the **FSA** understands to be generally regarded as good market practice and conventions in certain areas. It is not **guidance** on **rules**.

3.4 Standards expected of firms when undertaking inter-professional business

- 3.4.1 G This section 3.4 provides **guidance** on the interpretation of the **Principles** and in particular **Principle 1** (Integrity) **Principle 2** (Skill, care and diligence), **Principle 5** (Market conduct) and **Principle 7** (Communications with clients.)

- 3.4.2 G The *Principles*, as they apply to *inter-professional business*, will be interpreted on the basis that *market counterparties* do not need or expect the level of protection provided to *private customers* or *intermediate customers*. In many respects, inter-professional dealings are mutually self-disciplining. *Market counterparties* have commercial sanctions available if they consider the conduct of someone they conduct business with is unacceptable, and are responsible for their own decisions. These factors are relevant also to the *FSA's* interpretation of the provisions of this chapter.

SUITABILITY AND ADVICE

- 3.4.3 G The *Principles* do not require a *firm* to assess the suitability of a particular transaction for its *client* once it has established that it is dealing with a *market counterparty*. For example, the *firm* is not obliged to ensure that the *market counterparty* understands the risks involved; nor is it under any duty to provide best execution or other dealing protections (but see *MAR* 3.4.5G to *MAR* 3.4.10G).

- 3.4.4 G Similarly, a *firm* is not obliged to give *advice* to a *market counterparty*. The mere passing of information does not mean the *firm* has assumed responsibility for giving *advice* (see *PRIN* 3.4.1R). Although *Principle 7* requires a *firm* to pay due regard to the information needs of its "*clients*", the only requirement of *Principle 7* relating to *market counterparties* is that a *firm* must communicate information to *market counterparties* in a way that is not misleading.

COMMUNICATION OF INFORMATION

- 3.4.5 G *Principle 7* (Communications with clients) requires that a *firm's* communications with a market counterparty should not be misleading. Otherwise, for the reasons explained in *MAR* 3.4.4G, *Principle 7* does not apply to a *firm's* communications with *market counterparties*.
- 3.4.6 G If a *firm* volunteers information to a *market counterparty*, but no formal advisory arrangement is agreed, the *firm* need not advise a *market counterparty* about the reliability, relevance or importance of that information. Silence on the part of a *firm* does not result in a breach of *Principle 7*, unless, in the circumstances, it results in a communication made by a *firm* being misleading.
- 3.4.7 G It is for a *firm* to decide whether it wishes to provide information to a *market counterparty*. If it does so the *firm* is not obliged to keep the *market counterparty* informed of any changes to the information, unless the *firm* has agreed to do so.
- (1) Because the duties owed by a *firm* to a *market counterparty* are limited, it will frequently be the case that there will be no clash between the duties owed by the *firm* to the *market counterparty* and the *firm's* interests. There will in those cases be no requirement on the *firm* to disclose its interests.
 - (2) When a *firm* does owe a duty to a *market counterparty* that arises under the general law of contract (see *MAR* 3.4.9G) it should manage any conflict of interest. This can be achieved by the operation of internal Chinese Walls (in accordance with *COB* 2.4.) Otherwise, before it transacts, the *firm* should disclose the nature and extent of any material conflict to the *market counterparty*.
 - (3) This paragraph *MAR* 3.4.7G is guidance on *Principle 1* (Integrity) and *Principle 5* (Market conduct).
- 3.4.8 G The following are examples of where there may be responsibilities that potentially give rise to a duty to disclose material conflicts of interest to the *market counterparty*:

- (2) the *firm* has agreed to advise the *market counterparty*;
- (3) the *firm* otherwise owes fiduciary duties to the *market counterparty*.

3.4.9 G Thus, a *firm* acting as an *arranger* for a *market counterparty*, when the *firm* is an *affiliated company* of the other *principal*, should disclose that relationship to the *market counterparty*.

CLARITY OF ROLE

- 3.4.10 G A *firm* should ensure that it is clear to the *market counterparty* whether it is acting on its own account, as agent, or as arranger before it enters into a transaction. If a firm is acting as a *wholesale market broker*, it should indicate what type of *broker* it is, for example *name-passing broker* or matched principal broker. This paragraph, *MAR* 3.4.10G, is guidance on *Principle* 7 (Communications with clients).
- 3.4.11 G If a *firm* has agreed with a *market counterparty* to act in one capacity in a transaction, it should not then act in any other capacity in that transaction without the consent of that *market counterparty*. For example, if a *firm* bids to transact on an agency basis, it should not, without consent, execute any part of the trade against its own book.
- 3.4.12 G It is not consistent with acting solely as an *arranger* (or *name-passing broker*) to take positions, even fleetingly, or act on a matched principal basis in the course of that transaction.

MARKETING INCENTIVES, INDUCEMENTS AND PAYMENTS IN KIND

- 3.4.13 G *MAR* 3.4.14G and *MAR* 3.4.15G provide *guidance* on the interpretation of the *Principles* and in particular *Principle* 1 (Integrity), *Principle* 3 (Management and control) and *Principle* 5 (Market conduct) as they apply to marketing incentives, inducements and payments in kind.
- 3.4.14 G A *firm* should take reasonable steps to ensure that it, or any person acting on its behalf, does not offer, give, solicit or accept an inducement if it is likely to conflict to a material extent with any duty which a recipient *firm* owes to another person. Inducement can include entertainment and soft commissions.
- 3.4.15 G If a *firm* gives an inducement and the recipient, although a *market counterparty*, is acting on behalf of *customers*, the *firm* may be subject to the provisions of *COB* 2.2.
- 3.4.16 G A *firm* should make and implement appropriate systems, controls and policies consistent with *MAR* 3.4.15G.

3.5 Transactions at Non-Market Prices

INTRODUCTION

- 3.5.1 G A *firm* should not enter into a transaction which it knows to be improper, or which it should have realised is improper, whether on its own account or with a third party. *Firms* often do not have the information to be able to assess the reasons why a *market counterparty* is entering into a transaction, but from past experience, a good indication that the purpose may be improper is if the transaction is undertaken at a price other than at the prevailing market price. Failure to use prevailing rates or prices may result in a *firm* participating, whether deliberately or unknowingly, in the concealment of a profit or loss, or in the perpetration of a fraud. There may, however, be legitimate reasons for entering into transactions at non-market prices, and *MAR* 3.5 requires that a *firm* take reasonable steps to check this.

- 3.5.2 G *Firms* acting as *arrangers* (or *name-passing brokers*) have a more limited role in the transaction and *MAR* 3.5.3R and *MAR* 3.5.8E do not apply to them. Under *Principle* 1 (Integrity) and *Principle* 5 (Market conduct), a *firm* acting as *arranger* (or *name-passing broker*) should not conclude the arrangement if there is information from which it ought reasonably to conclude that the transaction is improper, whether or not it is at a non-market price. *Firms* acting as *arrangers* (or *name-passing brokers*) should also comply with obligations upon them arising from *ML*.

NON-MARKET-PRICE TRANSACTIONS

- 3.5.3 R Except where *MAR* 3.5.7R applies, a *firm* must not enter into, as agent or principal, a *non-market-price transaction* under which it *deals in an inter-professional investment* unless it has taken reasonable steps to ascertain that the transaction is not being entered into by the *market counterparty* for an improper purpose (see also *MAR* 3.5.8E).
- 3.5.4 R A *firm* must make and retain, for a period of three years, a record of the steps it has taken under *MAR* 3.5.3R, in relation to each transaction.
- 3.5.5 G A *non-market-price transaction* is a transaction where:
- (1) the *dealing* rate or price paid by the *firm* or its *market counterparty* differs from the prevailing market rate or price to a material extent; or
 - (2) the *firm* or its *market counterparty* otherwise gives materially more or less in value than it receives in return.
- 3.5.6 G The requirements upon *firms* when dealing with *customers* are set out in *COB* 7.16.
- 3.5.7 R *MAR* 3.5.3R does not apply to a *non-market-price transaction* if it is subject to the rules of an *RIE*.
- 3.5.8 E (1) To take reasonable steps as required by *MAR* 3.5.3R a *firm* should:
- (a) have in place procedures to enable it to identify *non-market-price transactions*;
 - (b) have in place a policy and procedure for the review (to take place before the *firm* commits itself to that transaction) of the *non-market-price transaction*:
 - (i) by an individual holding a senior position with the *firm*; or
 - (ii) in accordance with (2);and should follow that policy and procedure;
 - (c) ensure the review considers the reasons for the transaction; and
 - (d) check whether it has not been put on notice that the transaction is for an improper purpose.

- (2) A *firm* may have the review in (1)(b) carried out by an individual working for the *firm* who does not hold a senior position in the *firm* if:
 - (a) the policy and procedures established under (1) cover such reviews and have been approved by an individual holding a senior position with the *firm*;
 - (b) that policy sets out the categories of transaction that may be reviewed in this way;
 - (c) the transaction falls into one of those categories;
 - (d) the *firm* can demonstrate that it routinely enters into transactions of those categories and that those categories are so defined that there is a high probability that transactions coming within them will be for proper purposes;
 - (e) the factors defining those categories do not in substance involve any judgment of whether any purpose is improper;
 - (f) the policy provides for matters to be referred to a senior level in appropriate circumstances;
 - (g) those approving the policy are satisfied that all those who are eligible under the policy to participate in the review have the appropriate level of skills;
 - (h) the policy has due regard to segregation of responsibilities; and
 - (i) it keeps under review whether the categories of transaction established under (2) do have the result described in (2)(d).
- (3) Compliance with (1) and, to the degree relevant, (2) may be relied on as tending to show compliance with [MAR 3.5.3R](#).
- (4) Contravention of (1) or, to the degree relevant, (2) may be relied on as tending to show contravention of [MAR 3.5.3R](#).

WHETHER A TRANSACTION IS TO BE CONSIDERED A NON-MARKET-PRICE TRANSACTION

- 3.5.9 G Certain types of transactions or structured transactions are undertaken at non-market rates or prices, but are not necessarily considered to be *non-market-price transactions*.
- (1) One of these is a transaction with more than one component, where the individual components are entered into at non-market rates or prices, so long as the sum of the whole transaction produces an overall market rate or price. Examples are:
 - (a) asset swaps, where the underlying asset is sometimes sold at a non-market price. The fixed cash flows from the asset are then passed back to the seller, also at a non-market rate. Where neither the asset trade nor the swap is at a market rate, the overall transaction can be considered to be at the market price where the combination of the two components delivers this result; and

(b) other types of swaps, where one or both legs is not on the forward curve (showing implied forward rates or prices), for example when up-front or final payments are involved.

(2) Another is the purchase and sale of out of the money options. The fact that the strike price is away from the market price is not in itself sufficient to give rise to a *non-market-price transaction*. Other factors, such as the level of premium, must also be considered.

3.5.10 G Certain circumstances may result in a transaction being undertaken at a price other than the market price, for example:

- (1) the transaction is not for a marketable amount; or
- (2) an order has been carried out over a period of time; or
- (3) a transaction is executed outside normal market hours; or
- (4) a transaction has a non-standard settlement period;

and these circumstances may be relevant in assessing whether the transaction constitutes a *non-market-price transaction*.

3.5.11 G The question of whether a transaction is a *non-market-price transaction* is to be judged as at the time it is effected and not with hindsight.

3.5.12 G The variation or rolling over of an existing transaction should be regarded as a new transaction for the purposes of *MAR* 3.5.

WHETHER A TRANSACTION IS TO BE CONSIDERED TO BE FOR IMPROPER PURPOSES

3.5.13 G Examples of improper purposes for transactions (see *MAR* 3.5.3R) include:

- (1) the perpetration of a fraud;
- (2) the improper concealment of a profit or loss;
- (3) the disguising of the nature of a transaction or of profits, losses or cashflows;
- (4) transactions which amount to *market abuse*;
- (5) vulnerable transactions under the Insolvency Act 1986; and
- (6) "window dressing", in particular around the year end, to disguise the true financial position of the *person* concerned.

3.5.14 G A transaction may be for one or more of the purposes stated in *MAR* 3.5.10G yet still be carried out at a market price or otherwise not fall within the definition of *non-market-price transaction*. *MAR* 3.5 should not be taken as qualifying in any way obligations on *firms*, however these arise, regarding these transactions.

3.5.15 G When a *non-market price transaction* has more than one component, the assessment of whether or not the transaction is improper should be made by reference to the transaction as a whole. Although the judgment is formed with reference to the whole transaction, a *firm* may conclude that the rationale for one component would cause it to be in breach of *MAR* 3.5.3R.

- 3.5.16 G A transfer between a *firm* and its nominee or an intra-group transfer for risk management purposes will normally be for proper purposes. Where that is so, the *firm* may take part in it. However a *firm* should establish, and act in accordance with, a policy dealing with these transfers, and other intra-group *non-market-price transactions*, and be able to demonstrate that it has considered the consequences of participating in them.

PROCEDURES TO BE TAKEN BY A FIRM

- 3.5.17 G The procedures a *firm* has in place to identify *non-market-price transactions* should be appropriate for the types of transaction in question, bearing in mind *MAR* 3.5.9G to *MAR* 3.5.12G.
- 3.5.18 G When a *firm* proposes to enter into a *non-market-price transaction*, the personnel considering the transaction should:
- (1) consider the justification and rationale of the other parties to the proposed transaction and whether the decision to enter into it was taken by the parties concerned at a senior level, and not by an individual trader or treasurer; and
 - (2) (if the transaction is approved) be satisfied that all the material terms of the *non-market-price transaction* (so far as they affect the *firm*) have been agreed before the transaction is entered into and that they are promptly recorded in accordance with *MAR* 3.5.6E; material terms are likely to include the amounts each counterparty is to pay and receive and whether any amounts are to be netted against or offset against any amounts due and owing under a separate transaction.
- 3.5.19 G The degree of seniority referred to in *MAR* 3.5.8E(1)(b) may depend on the nature of the transaction.
- 3.5.20 G A *firm* operating an electronic matching system should consider implementing appropriate systems to identify potential *non-market-price transactions*. In these circumstances, it may be appropriate for such identification, and appropriate resulting action, to occur after the transaction has taken place.
- 3.5.21 G A *firm* may take all reasonable steps to ascertain its *market counterparty's* rationale for entering into the transaction, as set out in *MAR* 3.5.18G, but still be unable to find this out. It is up to the *firm*, having regard to the circumstances, to decide whether it is appropriate to enter into the transaction. One relevant circumstance is whether or not the *market counterparty* is another *firm*, in which case the *firm* is entitled to assume that the other *firm* is acting properly, in the absence of any further information to the contrary.

3.6 Taping

- 3.6.1 G (1) This section *MAR* 3.6 provides *guidance* on the interpretation of the *Principles*, and in particular *Principle* 3 (Management and control), as they apply to the capture of certain transactional information and other matters. *MAR* 3.6 applies only to *inter-professional business* and there are other requirements in the *Handbook* which relate to record-keeping requirements.
- (2) *MAR* 3.6 also provides additional *guidance* on the record-keeping requirements of *SYSC* 3.2.20R to 3.2.22G.

3.6.2 R *MAR* 3.6 does not apply:

- (1) to a *firm* acting in the course of carrying on the *regulated activities* of establishing, operating or winding up a *collective investment scheme*; or

(2) to an *insurer*; or

(3) in respect of a transaction if the *firm* is subject to record-keeping requirements in *COB* for that transaction.

- 3.6.3 G A *firm* should implement appropriate systems and controls with a view to ensuring that the material terms of all transactions to which it is a party, and other material information about such transactions, are promptly and accurately recorded in its books or records. The manner in which this information may be recorded include:
- (1) voice recordings of transactions;
 - (2) voice recordings of oral confirmations;
 - (3) written trading logs or blotters; and
 - (4) automated electronic records.
- 3.6.4 G A *firm* acting as an *arranger* (or *name-passing broker*) need record only those terms that are necessary for the transaction to be identified in its records or that are otherwise relevant to its role as *arranger*. For example, it would not normally know the payment and settlement instructions.
- 3.6.5 G A *firm* should be able to access all records as promptly as necessary. Records should be kept in comprehensible form or should be capable of being promptly so reproduced. The *firm* should make and implement appropriate procedures to avoid unauthorised alteration of its records.
- 3.6.6 G If the records identified in *MAR* 3.6.3G are substituted by written or electronic confirmations produced in accordance with *SYSC* 3.2.20R, then that confirmation may be an adequate record of the transaction.
- 3.6.7 G If a transaction is agreed or arranged through an electronic trading, matching and order-routing system, then the records provided by that system may be an adequate record of the transaction.
- 3.6.8 G A *firm* should keep under review whether, and to what extent, to make and retain voice recordings of its front and back office telephone lines used for negotiating, agreeing, arranging and confirming transactions and for the passing of payment instructions. (See also *MAR* 3.6.10G.)
- 3.6.9 G If a *firm* undertakes oral confirmations of the transactions it executes or *arranges*, voice recordings of these conversations can constitute an adequate record of that confirmation.
- 3.6.10 G In undertaking a review under *MAR* 3.6.8G, it is likely to be a relevant factor that voice recordings:
- (1) provide an immediate record of all transactions and therefore may assist *firms* in resolving any disputes;
 - (2) may assist a *firm* to identify whether any personnel of the *firm* or of its *market counterparty* are involved in inappropriate behaviour; *market counterparties* may take comfort in knowing that their transactions are immediately recorded and that this provides evidence that can be relied upon; and
 - (3) can provide evidence of the rationale for a particular trading strategy or other aspects of *inter-professional business* and thereby provide protection to the *firm*.

- 3.6.11 G A *firm* should make and implement policies on the length of time it keeps tapes. The *FSA* does not expect tapes to be kept for the full period required by the general record-keeping requirement, except where a *firm* relies upon voice recordings to comply with record-keeping requirements, in which case it should retain those recordings in accordance with the relevant requirements. One factor in setting that policy may be the use of tapes to assist the *firm* in resolving any disputes with *market counterparties*.

3.7 Firms acting as Wholesale Market Brokers and those undertaking transactions through them; provisions concerning brokers and arrangers generally

- 3.7.1 G *MAR* 3.7 provides *guidance* on the interpretation of the *Principles*, and in particular *Principle* 5 (Market conduct), as they apply to certain responsibilities of *firms* acting as *wholesale market brokers* and of *persons* undertaking transactions through them. In particular, it covers the passing of names and differences.
- 3.7.2 G The use of various terms for brokers and arrangers are based on the understanding that *name-passing brokers* are, in simple terms, what *arrangers* are called in certain wholesale markets. As such, the terms are virtually interchangeable and in *MAR* both terms have generally been used for the avoidance of doubt. Similarly, *name-passing brokers* and “matched principal brokers” are both subsets of *wholesale market brokers*. The use of the latter term is intended to reduce confusion.

PASSING OF NAMES

- 3.7.3 G A *firm* acting as a *name-passing broker* should not prematurely divulge the names of the prospective counterparties to each other, for example before both sides display a serious intention to transact. However, as soon as the material terms of a transaction have been agreed, a *firm* acting as a *name-passing broker* should aim to achieve a mutual and immediate exchange of names. When a *market counterparty* name is unacceptable to another, it is quite proper for a *firm* acting as a *name-passing broker* not to divulge by whom the name was refused.

SETTLEMENT OF DIFFERENCES

- 3.7.4 R *MAR* 3.7.5R to *MAR* 3.7.8G apply:
- (1) to a *firm* when it acts as a *name-passing broker*; and
 - (2) to a *firm* whether acting as *principal* or *agent*, when its transaction is *arranged* by a *firm* acting as a *name-passing broker*.
- 3.7.5 R (1) If a *firm* acting as a *name-passing broker* compensates a *market counterparty* for a difference, that difference must be settled in *money* (which for these purposes includes payment by discounting, reducing or rebating commission).
- (2) A “difference” in (1) means (in *MAR* 3.7.5R to *MAR* 3.7.8G) any difference between a rate or price quoted by a *firm* acting as a *name-passing broker* and the rate or price at which the transaction is ultimately concluded.

- 3.7.6 G When arranging a transaction, a *name-passing broker* is trying to achieve a mutual and immediate exchange of names, based on firm quotation of prices. Inevitably, for non-electronic *arrangers*, there will be occasions when the transaction is not completed at the original price (for instance because a firm price has been hit by another counterparty). The *name-passing broker* is said to have missed the original price when a *market counterparty* accepts a firm quote at that price, but the *name-passing broker* is unable to arrange for the deal to be completed at that price.
- 3.7.7 G A *firm* acting as a *name-passing broker* should not ordinarily accept liability for differences and should provide its services on the basis that it does not do so. (This is because accepting liability for differences amounts to taking a position legally and economically, and the *name-passing broker* would not be following *MAR* 3.4.12G.) A *firm* doing business with a *name-passing broker* should not, in the ordinary course, ask the latter for compensation for differences. However, once a difference has arisen, a *firm* acting as a *name-passing broker* may offer to compensate its *market counterparty* for some or all of the difference to preserve the relationship with the *market counterparty* concerned or for other legitimate commercial reasons. That compensation should be in accordance with *MAR* 3.7.5R.
- 3.7.8 G When a price has been missed, a *firm* acting as principal or agent should generally complete the transaction at the next available price through the *name-passing broker* that has missed the original price. To do otherwise can be prejudicial to the smooth operation of the markets. If the *firm* does not proceed with the transaction, it should first consider whether withdrawing would be likely to affect the market concerned, and should immediately communicate its decision to the *name-passing broker*. The *firm* should not decline to enter into the transaction at the new price if it would breach a reasonable expectation on the part of the *name-passing broker* that it would not do this.

GENERAL PROVISIONS ON WHOLESALE MARKET BROKERS AND ARRANGERS

- 3.7.9 G Any payment for broking or arranging services rendered by a *firm*, other than on a matched principal basis, should be in *money* (which for these purposes includes payment by discounting, reducing or rebating commission) unless otherwise agreed in writing between the parties.
- 3.7.10 G A *firm* acting as a *wholesale market broker* or *arranger* should not unfairly favour one *market counterparty* client over another. Treatment that would otherwise have been unfair is not unfair if the *market counterparty* concerned has expressly consented to it. The “client” of a *wholesale market broker* or *arranger* means (in *MAR* 3.7.10G and *MAR* 3.7.11G) a *person* for whom it is providing its services as *wholesale market broker* or *arranger*.
- 3.7.11 G A *firm* should not place an order with a *firm* acting as a *wholesale market broker* or *arranger* if the main purpose is to ascertain either the identity of any client of that *firm*, or information about transactions into which that client may be interested in entering. For example, a *firm* that wishes to purchase 1000 bonds should not have a *firm arrange* for the purchase of 100, in order to discover the identity of a *person* willing to sell those bonds, and then transact with that other *person* direct for the other 900.

3.8 Codes of Practice

- 3.8.1 G The *FSA* does not endorse individual codes of practice applying to *inter-professional business* (except for the *Takeover Code*) that are in place in some markets. It will, however, take into account the differing standards and practices operating in markets when interpreting the *Principles* as they apply to *inter-professional business*. Further, non-compliance with those codes, or of the Non-Investment Products Code in respect of certain non-authorisable activities, may raise issues such as the integrity or competence of a *firm* which are relevant to the threshold conditions (see *COND* X.8.6G(4)).

MAR 3 Ann 1G – Guidance on scope of the code (see MAR 3.3.1G)

- 1 This chapter, *MAR 3*, applies to *firms* in their dealings with *market counterparties*, as set out in *MAR 3.1.2R*. When *market counterparties* have opted to be treated as *intermediate customers* under *COB 4.1.5R*, this chapter does not apply. The requirements on *firms* in such circumstances are those set out in *COB. MAR 3* does, however, apply to *firms* in their dealings with *intermediate customers* who have opted to be treated as *market counterparties* under *COB 4.1.10R*.
- 2 This chapter sets out the requirements upon *firms* in their dealings with *market counterparties*. The way a *firm* is assessed under *COB 4.1* has no bearing on its obligations to assess its own *clients*.
- 3 The list of activities in *MAR 3.1.2R* is not based on types of *permission*. It is based on the activities of *dealing, arranging deals* and *investment advice*. This means, for example, that a *firm* may be subject to *MAR 3* if it purchases securities in the course of:
 - (1) operating a *collective investment scheme*; or
 - (2) acting as a life insurance company; or
 - (3) acting as agent for a *customer*;

in making that purchase. This is notwithstanding that the operation of a *collective investment scheme*, acting as a life insurance company and acting for a *private customer* are not activities that are covered by this chapter in their own right.

- 4 *MAR 3* does not affect the application provisions of the *Principles* (see *PRIN*). The purpose of the application provisions of *MAR 3*, as they apply to the *guidance* on the *Principles*, is to explain in what situations *MAR 3* may be used as *guidance* for interpreting the *Principles*. If *MAR 3* is silent about how the *Principles* apply to a particular situation, the *Principles* still apply.
- 5 *MAR 3* is intended to cover the whole range of *inter-professional business*. It is not, in general, specifically tailored for particular types of business, nor is it a comprehensive statement of how the *Principles* apply to *inter-professional business* in all situations. The *guidance* on the *Principles* in *MAR 3* should be read in the light of other requirements that may be applicable in a particular case. For example, this *guidance* applies to *on-exchange* business, and does not therefore take into account specific rules of exchanges.
- 6 The application provisions in *MAR 3.1.2R* mean that *corporate finance business* will normally be outside the scope of this chapter. However, *firms* should note that some activities, such as dealing, carried out in connection with *corporate finance business*, may be subject to this chapter.
- 7 This chapter does not apply to the approval by *firms* of a *financial promotion* (see *MAR 3.1.3R*); *rules* and *guidance* relating to *financial promotions* are in *COB 3*; *firms* are therefore advised to read this in conjunction with the provisions of the Financial Promotions Order regarding the treatment of “professional investors”, as defined in that order.
- 8 The same transaction may give rise to obligations under this chapter and another sourcebook, such as *COB*. For example, if a *firm* purchases an *inter-professional investment* from a *market counterparty* on behalf of a *customer*, this chapter applies to the relationship between the *firm* and the *market counterparty*. *COB* governs the relationship between the *firm* and the *customer*.
- 9 A transaction may be *inter-professional business* even though it is carried out from a place of business established outside the *United Kingdom*. If such a transaction is carried out by unauthorised *persons* or overseas offices of *UK domestic firms* except for final booking, but is then booked through a *UK domestic firm*, that *UK domestic firm* is subject to this chapter in relation to the transaction.
- 10 Nothing in this chapter:

- (1) modifies any duty owed by a *firm* to a *private customer* or *intermediate customer* under the provisions of any other part of the *Handbook*; or
- (2) relieves a *firm* of any other obligation to which it may be subject under the general law; or
- (3) should be read as qualifying or modifying the *Code of Market Conduct*, the *Code of Practice for Approved Persons* or the *Principles for Approved Persons*.

MAR 3 Ann 2G - Other relevant Handbook provisions (see MAR 3.3.2G)

This table lists the *Principles* that apply to *firms* carrying on *inter-professional business*, and also sets out some of the key provisions of *COB* that apply.

Rule	Description
Principle 1	A <i>firm</i> must conduct its business with integrity.
Principle 2	A <i>firm</i> must conduct its business with due skill, care and diligence.
Principle 3	A <i>firm</i> must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems
Principle 4	A <i>firm</i> must maintain adequate financial resources.
Principle 5	A <i>firm</i> must observe proper standards of market conduct.
Principle 7	A <i>firm</i> must communicate information [to its <i>clients</i>] in a way which is not misleading.
Principle 10	A <i>firm</i> must arrange adequate protection for <i>clients'</i> assets when it is responsible for them.
Principle 11	A <i>firm</i> must deal with its regulators in an open and cooperative way, and must disclose to the <i>FSA</i> appropriately anything relating to the <i>firm</i> of which the <i>FSA</i> would reasonably expect notice.
COB 3	Financial promotion (relating to the approval of a financial promotion, see <i>MAR 3 Ann 1G</i>)
COB 2.4	Chinese Walls
COB 4.1	Client classification
COB 7.14	Personal Account Dealing
COB 9	Client assets

MAR 3 Ann 3G - General information on good market practice (see MAR 3.3.3G)

INTRODUCTION

- 1 This annex, *MAR 3 Ann 3G*, is a statement of what the *FSA* understands to be generally regarded as good market practice and conventions in certain areas. It is not *guidance* on *rules* and is issued under section 157(1)(d) of the *Act*. This annex applies to all kinds of *inter-professional business*. It will be evident that much of the content is equally applicable to *market counterparties* as well as *firms*.

CONFIDENTIALITY

- 2 When information is received from a *market counterparty* under conditions of confidentiality, that confidentiality is likely to be enforceable by the owner of that information. Confidentiality should be respected, subject to regulatory and legal requirements.
- 3 *Firms* are reminded that the use of loudspeakers in broking and dealing rooms in close proximity to other lines of communication could result in breaches of confidentiality.

NEGOTIATION OF TRANSACTIONS

- 4 It is good practice for a *firm* to agree expressly all the economic terms of a transaction before it commits itself to the transaction. A *firm* should negotiate the remaining terms in good faith and try to agree them as soon as possible.
- 5 It is good practice for a *firm* to regard itself as bound to transact once the rate or price and any other key commercial terms have been agreed (whether orally or in written form), unless the parties explicitly and unambiguously agree to the contrary.
- 6 Generally, a *firm* that regularly uses the services of a *firm* acting as a *name-passing broker* should indicate to it the *market counterparties* with which, and the *investments* in which, it is not prepared to transact. That indication should not be in a form which would damage or lower the standing or reputation of the *market counterparty* in the estimation of reasonable *market counterparties* if they knew of it. A *firm* which is given an indication should treat it as confidential.

FIRMNESS OF QUOTATION

- 7 It is good practice for a *firm* to follow market conventions regarding quotation, unless it has specifically agreed otherwise with its *market counterparty* in advance. It should be clear to a *market counterparty*:
- (1) whether the quote is firm or not;
 - (2) whether the quote is subject to any conditions, and, if it is, what they are;
 - (3) for how long the quote remains firm (in fast moving markets, when practicable); and
 - (4) whether the quote is firm only for the normal marketable amount (if appropriate, otherwise the *firm* should state the size of the quote).
- 8 Express clarification of these matters is not necessary to the extent that the *firm* quotes in accordance with the relevant market convention or exchange rules (if applicable).

- 9 When a *firm* quotes to a *market counterparty* a firm rate or price (whether through an arranger, or *name-passing broker*, or directly), it is not good practice for the *firm* then to withdraw that quote or, if that quote is accepted during the period for which the quote remains firm, to decline to deal at that rate or price. A *firm* may decline to deal with a *market counterparty* in these circumstances if it was unaware of its identity when the *firm* gave the quote and the name turns out to be unacceptable, for example, on the grounds of credit risk.

LIMIT ORDERS

- 10 Before a *firm* accepts any limit order from a *market counterparty*, it is good practice to have made and implemented appropriate:
- (1) policies on these orders and in particular the circumstances in which and the terms on which it will accept these orders; and
 - (2) systems and controls for carrying them out.
- 11 A limit order means a stop loss order and any other instruction from a *market counterparty* to execute transactions if rates or prices reach specified levels. These orders may be time limited or may be for an indefinite period.

OUT OF HOURS/OFFICE DEALING

- 12 It is good practice for *firms* to issue guidelines to their staff on transactions entered into after normal hours or from outside premises, either by mobile phone or any other equipment. The guidelines should cover:
- (1) the type of transactions which may be undertaken in this way;
 - (2) where and with whom these transactions may be executed;
 - (3) permitted limits;
 - (4) how and when these transactions should be booked into and recorded on the front and back office systems; and
 - (5) how and when these transactions are to be confirmed.

- 13 When answering machines are used for instant reporting and recording of all off-premises transactions, they should be installed and located in such a way that reported transactions cannot subsequently be erased without senior management approval.

- 14 The use of mobile phones for business purposes from within the dealing room, except in an emergency, is considered bad practice.

SETTLEMENT ERRORS

- 15 If a *firm* becomes aware of a settlement error that benefits it at the cost of a *market counterparty*, it is good practice to inform the *market counterparty* promptly and reverse the error.
- 16 If a *firm*, acting as a *broker*, becomes aware that it is holding assets on behalf of a *market counterparty* because of a settlement error which adversely affects that *market counterparty*, it is good practice to inform the *market counterparty* promptly and try to rectify the situation.

CONFIRMATIONS

- 17 Confirmations provide a useful safeguard against dealing errors and can be a valuable element in the control of the *firm's inter-professional business* and exposures. It is good practice for a *firm* to make available to, or provide to, the *market counterparty* written confirmation of the material terms of a transaction between them, as soon as possible after the transaction has been agreed or executed.
- 18 It is acceptable market practice for the *firm* to agree with its *market counterparty* that only one party need send a confirmation. If a *firm* undertakes this practice to a material extent, it is advisable to identify the legal and other risks involved and address them in the *firm's* risk control policies.
- 19 If there is a standard form of confirmation that applies to a transaction a *firm* enters into, it is good practice to ensure that that form is used, unless there is good reason not to. One example of when there is an applicable standard form confirmation is when the parties enter into the transaction under the terms of a master agreement that provides for an applicable form of confirmation. Another is when it is customary in the market concerned to use a particular form of confirmation for transactions of that kind.
- 20 In general, it is not good practice for confirmations to be issued by or sent to the individual dealer responsible for the transaction. It is good practice to ensure that the dealer concerned is not responsible for checking confirmations unless there are exceptional circumstances. If the dealer is given that responsibility, it is good practice to subject the process to independent monitoring.
- 21 In general, it is good practice for a *firm* which *arranges* a transaction to try to ensure that the parties agree who is to issue a confirmation.
- 22 Some transactions are matched through an electronic matching system that does not provide for the issue of confirmations, but instead makes and retains records of transactions itself. In these cases, it may be appropriate for a *firm* neither to receive nor issue confirmations, provided the system allows for the back offices of users to verify the details of transactions entered into on the system.
- 23 The statements of good practice in paragraphs 17 to 22 do not apply to *on exchange* business.

STANDARD SETTLEMENT INSTRUCTIONS

- 24 It is good practice for a *firm* to make and implement appropriate policies on the use of standard settlement instructions (SSIs) to reduce the incidence and size of differences arising from a mistaken settlement of funds. These are especially appropriate when the *firm* has a relationship with a *market counterparty* which suggests there will be regular payment of significant amounts.
- 25 It is good practice to establish SSIs in a secure and verifiable format. A *firm* acting as an *arranger* (or *name-passing broker*) has no responsibility for ensuring that its *market counterparties* have SSIs in place.

MASTER AGREEMENTS

- 26 *Firms* are encouraged to negotiate and execute master agreements. These govern the relationship between the parties and how such a relationship and all transactions under it shall be terminated in the event of one party's default upon a transaction. It is recognised that executed documentation can be and should be used as an efficient risk management tool. *Market counterparties* should consider the benefits of valid close out netting provisions (see *IPRU*).

- 27 If it is the policy of a *firm* to use master agreements, it is good practice to make and implement policies for what transactions should be subject to the terms of which master agreement and have systems and controls for ensuring compliance with that policy. If a *firm* has a policy that transactions should be entered into with a *market counterparty* only after a master agreement has been implemented, it is advisable to have procedures to ensure that any exceptions are agreed at an appropriate level.

COMMISSION/BROKERAGE

- 28 It is good practice for *firms* acting as principals to pay due brokerage bills promptly. Overdue payments can seriously disadvantage *wholesale market brokers*, since overdue payments result, in their treatment by the *FSA* for regulatory purposes, as an increase in their cost of capital.

DISPUTES

- 29 In the event of a dispute between a *firm* and a *market counterparty*, it is preferable for the parties to seek to resolve the issues themselves. If they cannot reach agreement, they should consider the advantages of using established arbitration or mediation services.

Schedule: Actions for Damages for Breach of Rules

A contravention of any of the *rules* in this instrument does not give rise to a right of action by a private person under section 150(1) of the Act (and each of the *rules* in this instrument is specified under section 150(2) of the Act as a provision giving rise to no such right of action.)

DEFINED TERMS IN MAR 3: INTER-PROFESSIONAL CONDUCT

<i>the Act</i>	the Financial Services and Markets Act 2000;
<i>affiliated company</i>	in relation to a <i>person</i> , an <i>undertaking</i> in the same <i>group</i> as that <i>person</i> ;
<i>ancillary activity</i>	an activity that is not a <i>regulated activity</i> but is: (a) carried on in connection with a <i>regulated activity</i> ; or (b) held out as being for the purposes of a <i>regulated activity</i> .
<i>appointed representative</i>	a <i>person</i> (other than an authorised person) who: (a) is a party to a contract with an <i>authorised person</i> (his <i>principal</i>) which: (i) permits or requires him to carry on business of a description prescribed in the Financial Services and Markets Act 2000 (Appointed Representatives) Regulations 2001; and (ii) complies with such requirements as may be prescribed in that order, and (b) is someone for whose activities in carrying on the whole or part of that business his <i>principal</i> has accepted responsibility in writing; and who is therefore an <i>exempt person</i> in relation to any <i>regulated activity</i> comprised in the carrying on of that business for which his <i>principal</i> has accepted responsibility, in accordance with section 35 of <i>the Act</i> ;
<i>approve</i>	(in relation to a financial promotion), approve the content of the financial promotion for the purposes of section 21 of the Act.
<i>arranger</i>	a <i>person</i> who is arranging (bringing about) deals in <i>investments</i> , making <i>arrangements</i> with a view to transactions in <i>investments</i> , or agreeing to carry on any of those activities.
<i>arranging deals for another</i>	the <i>regulated activity</i> , specified in article 22(1) of the <i>Regulated Activities Order</i> (Arranging deals in investments), which is in summary: making arrangements for another <i>person</i> (whether as <i>principal</i> or agent) to buy, sell, subscribe for or underwrite a particular <i>investment</i> which is: (a) a <i>security</i> ; (b) a <i>contractually based investment</i> ; or

(c) the underwriting capacity of a Lloyd's syndicate;

(d) membership of a Lloyd's syndicate;

(a) (e) rights to interests in (c) or (d).

behaviour

in accordance with section 118(10) of the Act (Market abuse): any kind of conduct, including action or inaction

broker

any *person* when dealing as agent;

buying

any form of buying, including acquiring for valuable consideration in accordance with article 3(1) of the *Regulated Activities Order* (Interpretation: general).

client

(1) (except in ML and PROF) any person with or for whom a firm carries on or intends to carry on designated investment business or any other regulated activity and:

(a) every client is a customer or a market counterparty;

(b) "client" includes:

(i) a potential client;

(ii) a client of an appointed representative of a firm with or for whom the appointed representative acts or intends to act, in the course of business for which the firm has accepted responsibility under section 39 of the Act (Exemption of appointed representatives);

(iii) if a person ("C1"), with or for whom the firm is conducting designated investment business, is acting as agent for another person ("C2"), either C1 or C2 in accordance with COB 4.1.4R (Agent as client);

(c) "client" does not include:

(i) a trust beneficiary;

(ii) a corporate finance contact;

(iii) a venture capital contact.

(2) (in ML) (in relation to a relevant firm) any person engaged in, or who has had contact with the relevant firm with a view to engaging in, any transaction with that relevant firm:

(a) on his own behalf; or

(b) as agent for or on behalf of another.

(3) (in PROF) (as defined in section 328(8) of the Act (Directions in relation to the general prohibition)) (in relation to members of a profession providing financial services under Part XX of the Act (Provision of Financial Services by Members of the Professions)):

(a) a person who uses, has used or may be contemplating using,

any of the services provided by the member of a profession in the course of carrying on exempt regulated activities (including, where the member of the profession is acting in his capacity as a trustee, a person who is, has been or may be a beneficiary of the trust); or

(b) a person who has rights or interests which are derived from, or otherwise attributable to, the use of any such services by other persons; or

(c) a person who has rights or interests which may be adversely affected by the use of any such services by persons acting on his behalf or in a fiduciary capacity in relation to him.

client money

subject to the client money rules, *money* of any currency which, in the course of carrying on designated investment business, a *firm* holds in respect of any investment agreement entered into, or to be entered into, with or for a *client*, or which a *firm* treats as *client money* in accordance with the *client money* rules.

COB

Conduct of Business Sourcebook;

Code of Market Conduct

the code required to be prepared and issued by the *FSA* under section 119 of the *Act*;

collective investment scheme (CIS)

in accordance with section 235 of the *Act* (Collective investment schemes), any arrangements with respect to property of any description, including *money*, the purpose or effect of which is to enable *persons* taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income, which are not excluded by the Financial Services and Markets Act (Collective Investment Schemes) Order 2001.

communicate

(in relation to a *financial promotion*) in accordance with section 21(13) of the *Act* (Restrictions on financial promotion), to communicate in any way, including causing a communication to be made.

Compensation Scheme

the Financial Services Compensation Scheme established under section 213 of the *Act* (The compensation scheme) for compensating persons in cases where authorised *persons* and *appointed representatives* are unable, or are likely to be unable, to satisfy claims against them.

core investment service

a service listed in section A of the Annex to the ISD, the text of which is set out in Schedule 2 to the *Regulated Activities Order* and in SUP 13 Ann 3G.

corporate finance business

(a) designated investment business conducted with or for:
(i) an issuer, holder or owner of designated investments, where

that business relates to the offer, issue, underwriting, repurchase, exchange or redemption of, or the variation of the terms of, those investments, or any related matter;

(ii) a person whose business relates to the manner in which, or the terms on which, or the persons by whom, any business, activities or undertakings relating to it, or any associate, are to be financed, structured, managed, controlled, regulated or reported upon;

(iii) any body corporate in connection with:

(A) a proposed or actual takeover or related operation by or on behalf of, or involving investments issued by, that body corporate or its holding company, subsidiary or associate; or

(B) a merger, de-merger, reorganisation or reconstruction involving any investments issued by that body corporate, its holding company, subsidiary or associate;

(iv) any shareholder or prospective shareholder of a company established or to be established for the purpose of effecting a takeover or related operation, where that business is in connection with that takeover or related operation;

(v) a person who, acting as a principal for his own account:

(A) is involved in negotiations or decisions relating to the commercial, financial or strategic intentions or requirements of a business or prospective business; or

(B) (provided he is acting otherwise than solely in his capacity as an investor) assists the interests of another person with or for whom the firm, or another authorised or overseas person, is undertaking business as specified in (a)(i),(ii),(iii) or (iv), by himself undertaking all or part of any transactions involved in such business;

(vi) a person undertaking business with or for a person as specified in (a)(i), (ii), (iii) or (iv) in respect of activities described in those sub-paragraphs;

(b) designated investment business carried on by a firm as a principal for its own account where such business:

(i) is in the course of, or arises out of, activities undertaken in accordance with (a); and

(ii) does not involve transactions with or for, or advice to, other persons who are private customers in respect of such business;

(c) designated investment business which is carried on by a firm as principal for its own account where such business:

(i) involves:

(A) the offer, issue or underwriting of a firm's own shares or debentures or, the repurchase, exchange or redemption of, or the variation of the terms of such shares or debentures, or any related matter;

(B) a proposed or actual takeover or related operation by or on behalf of the firm, or involving designated investments issued by it;

(C) a merger, de-merger, reorganisation or reconstruction involving designated investments issued by the firm; and

(ii) does not involve:

(A) advice to persons who are private customers in respect of

such designated investment business or business carried on in connection with it;

(B) recommendations given by a firm, or by the directors of a firm, to holders of the firm's shares or debentures in connection with such business.

- corporate finance contact*** (when a firm carries on designated investment business with or for a person in the course of or as a result of either carrying on corporate finance business with or for a client, or carrying on corporate finance business for the firm's own account) that person in connection with that designated investment business if:
- (a) the firm does not behave in a way towards that person which might reasonably be expected to lead that person to believe that he is being treated as a client; and
 - (b) the firm clearly indicates to that person that it:
 - (i) is not acting for him; and
 - (ii) will not be responsible to him for providing protections afforded to clients of the firm or be advising him on the relevant transaction
- credit institution*** an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account, and which is authorised as a credit institution for the purposes of the Banking Consolidation Directive.
- customer*** a *client* who is a *private customer* or an *intermediate customer*.
- deal*** a *dealing* transaction
- dealing*** in accordance with paragraph 2 of Schedule 2 to the *Act*.
- derivative*** a contract for differences, future or an option whose value derives from any underlying commodity, index, security or other asset.
- designated investment*** any of the following investments specified in Part III of the Regulated Activities Order (Specified investments):
- (a) life policies (subset of article 70);
 - (b) shares (article 71);
 - (c) debentures (that is, instruments creating or acknowledging indebtedness) (article 72);
 - (d) government and public securities (article 73);
 - (e) warrants (that is, instruments giving entitlement to investments) (article 74);
 - (f) certificates representing certain securities (article 75);
 - (g) units (article 76);

- (h) options (article 77); for the purposes of the permission regime, these have been sub-divided into:
 - (i) options (excluding commodity options and options on commodity futures);
 - (ii) commodity options and options on commodity futures;
- (i) futures (article 78); for the purposes of the permission regime, these have been sub-divided into:
 - (i) futures (excluding commodity futures);
 - (ii) commodity futures;
- (i) contracts for differences (article 79); for the purposes of the permission regime, these have been sub-divided into:
 - (j) contracts for differences (excluding speculative contracts and rolling spot forex contracts);
 - (ii) speculative contracts;
 - (iii) rolling spot forex contracts;
- (k) rights to or interests in an investment within (a) to (i) (article 83).

designated investment business

- any of the following regulated activities specified in Part II of the Regulated Activities Order and which is carried on by way of business:
- (a) dealing in investments as principal (article 12), but including activities that come within the exclusion in article 13 (Absence of holding out etc);
 - (b) dealing in investments as agent (article 19);
 - (c) arranging deals in investments for another person (article 22(1)) but only in relation to designated investments;
 - (d) making arrangements for deals in investments (article 22(2)) but only in relation to designated investments;
 - (e) managing investments (article 33);
 - (f) safeguarding and administration of assets (article 36); for the purposes of the permission regime, this is sub-divided into:
 - (i) safeguarding and administration of assets;
 - (ii) arranging safeguarding and administration of assets;
 - (g) sending dematerialised instructions (article 42(1));
 - (h) causing dematerialised instructions to be sent (article 42(2));
 - (i) establishing, operating or winding up a collective investment scheme (article 48(1)); for the purposes of the permission regime, this is sub-divided into:
 - (i) establishing, operating or winding up a regulated collective investment scheme;
 - (ii) establishing, operating or winding up an unregulated collective investment scheme;
 - (j) acting as trustee of an authorised unit trust scheme (article 48(2));
 - (k) acting as the depository or sole director of an open-ended investment company (article 48(3));
 - (l) advising on investments (article 49); for the purposes of the permission regime, this is sub-divided into:
 - (i) advising on investments (except on pension transfer and pension

opt outs);
(ii) advice on pension transfers and opt outs;
(m) agreeing to carry on the activities in (a) to (h) and (l) (article 59).

<i>director</i>	(in relation to any of the following (whether constituted in the United Kingdom or under the law of a country or territory outside it)): (a) an unincorporated association; (b) a body corporate; (c) (in SYSC and SUP 10 (Approved persons)) a partnership; (d) (in SYSC and SUP 10 (Approved persons)) a sole trader; any person appointed to direct its affairs, including (in accordance with section 417(1) of the Act): (i) a person occupying in relation to it the position of a director (by whatever name called); and (ii) (except in relation to an ICVC) a person in accordance with whose directions or instructions (not being advice given in a professional capacity) the directors of that body are accustomed to act.
<i>employee</i>	an individual who is employed or appointed by a person in connection with the person's business, whether under a contract of service or for services or otherwise, but excluding an appointed representative of the person.
<i>European Economic Area (EEA)</i>	the area established by the agreement on the European Economic Area signed at Oporto on 2 May 1992 and which consists of the EEA States.
<i>financial promotion</i>	in accordance with section 21(1) of the <i>Act</i> (Restrictions on financial promotion): an invitation or inducement to engage in investment activity.
<i>firm</i>	an <i>authorised person</i> ;
<i>friendly society</i>	an incorporated friendly society or a registered friendly society.
<i>FSA</i>	the Financial Services Authority;
<i>group</i>	(as defined in section 421 of the Act (Group)) (in relation to a person ("A")) A and any person who is: (a) a parent undertaking of A; (b) a subsidiary undertaking of A; (c) a subsidiary undertaking of a parent undertaking of A; (d) a parent undertaking of a subsidiary undertaking of A; (e) an undertaking in which A or an undertaking in (a) to (d) has a participating interest; (f) if A or an undertaking in (a) or (d) is a building society, an associated undertaking of that society; (g) if A or an undertaking in (a) or (d) is an incorporated friendly

society, a body corporate of which the society has joint control (as defined in section 13(9)(c) or (cc) of the Friendly Societies Act 1992); in this definition:

(i) "participating interest" has the same meaning as in Part VII of the Companies Act 1985 or Part VIII of the Companies (Northern Ireland) Order 1986; but also includes an interest held by an individual which would be a participating interest for the purposes of those provisions if he were an undertaking;

(ii) "associated undertaking" has the meaning given in section 119(1) of the Building Societies Act 1986.

(see also immediate group)

guidance

guidance given by *the FSA* in accordance with *the Act*;

home state

(1) (in relation to a credit institution), the EEA State in which the credit institution has been authorised in accordance with the Banking Consolidation Directive.

(2) (in relation to an *investment firm*):

(a) where the *investment firm* is a natural *person*, the EEA State in which his head office is situated;

(b) where the *investment firm* is a legal *person*, the EEA State in which its registered office is situated or, if under its national law it has no registered office, the EEA State in which its head office is situated.

(3) (in relation to an insurer with an EEA right), the EEA State in which the registered office of the insurer is situated.

(4) (in relation to a market), the EEA State in which the registered office of the body which provides trading facilities is situated or, if under its national law it has no registered office, the EEA State in which that body's head office is situated;

(5) (in relation to a Treaty firm), the EEA State in which its head office is situated, in accordance with paragraph 1 of Schedule 4 to the *Act* (Treaty rights).

home state regulator

(1) (in relation to an *EEA firm*) the competent authority (as defined in paragraph 9 of Schedule 3 to the *Act* (EEA Passport Rights))

(2) (in relation to a *UK firm*) the *FSA* (under the relevant Single Market Directive) of an EEA State (other than the *United Kingdom*) in relation to the *EEA firm* concerned.

incoming EEA firm

(1) (in accordance with section 193(1)(a) of the *Act*) an *EEA firm* which is exercising, or has exercised, its right to carry on a regulated activity in the *United Kingdom* in accordance with Schedule 3 to the *Act* (EEA Passport Rights).

<i>incoming Treaty firm</i>	(in accordance with section 193(1)(b) of the Act) a Treaty firm which is exercising, or has exercised, its right to carry on a regulated activity in the United Kingdom in accordance with Schedule 4 to the Act (Treaty Rights).
<i>insurer</i>	a <i>firm</i> other than a bank with permission to effect or carry out contracts of insurance.
<i>intermediate customer</i>	<p>a client who is not a market counterparty and who is:</p> <ul style="list-style-type: none"> (a) a local authority or public authority; (b) a body corporate whose shares have been listed or admitted to trading on any EEA exchange; (c) a body corporate whose shares have been listed or admitted to trading on the primary board of any IOSCO member country official exchange; (d) a body corporate (including a limited liability partnership) which has (or any of whose holding companies or subsidiaries has) (or has had at any time during the previous two years) called up share capital or net assets of at least £5 million (or its equivalent in any other currency at the relevant time); (e) a special purpose vehicle; (f) a partnership (but not including a limited liability partnership) or unincorporated association which has (or has had at any time during the previous two years) net assets of at least £5 million (or its equivalent in any other currency at the relevant time) and calculated in the case of a limited partnership without deducting loans owing to any of the partners; (g) a trustee of a trust (other than a regulated collective investment scheme, an occupational pension scheme, SSAS or stakeholder pension scheme) which has (or has had at any time during the previous two years) assets of at least £10 million (or its equivalent in any other currency at the relevant time) calculated by aggregating the value of the cash and designated investments forming part of the trust's assets, but before deducting its liabilities; (h) a trustee of an occupational pension scheme, SSAS or stakeholder pension scheme where the trust has (or has had at any time during the previous two years): <ul style="list-style-type: none"> (i) at least 50 members; and (ii) assets under management of at least £10 million (or its equivalent in any other currency at the relevant time); (i) another firm, or an overseas financial services institution, when, in relation to designated investment business, or related ancillary activities, conducted with or for that firm or institution, that firm or institution is an intermediate customer in accordance with COB 4.1.7R (Classification of another firm or an overseas financial

services institution);

(j) an unregulated collective investment scheme (or, if that scheme is a unit trust scheme, its trustees);

(k) a client when he is classified as an intermediate customer in accordance with COB 4.1.9R (Expert private customer classified as intermediate customer);

but excluding:

(A) a regulated collective investment scheme (or, if that scheme is a unit trust scheme, its trustees); and

(B) a client who would otherwise be an intermediate customer, when he is classified in accordance with:

(I) COB 4.1.12R (Large intermediate customer classified as market counterparty); or

(II) (except for the purposes of DISP) COB 4.1.14R (Client classified as private customer).

***inter-professional
business***

the business of a firm:

(a) when it carries on:

(i) regulated activities; or

(ii) related ancillary activities;

to the extent that the relevant regulated activity that the firm is carrying on is:

(A) dealing; or

(B) acting as an arranger or agreeing to do so; or

(C) giving transaction-specific advice or agreeing to do so;

but only if that activity is:

(I) in or in respect of an inter-professional investment;

(II) undertaken with or for a market counterparty; and

(III) carried out from an establishment maintained by the firm in the United Kingdom;

(b) but excluding the carrying on of the following activities:

(i) the approval by a firm of the contents of a financial promotion;

(ii) activities carried on between operators, or between operators and trustees, of the same collective investment scheme (when acting in that capacity);

(iii) corporate finance business;

(iv) the regulated activities of safeguarding and administration of assets and of agreeing to carry on that activity.

***inter-professional
investment***

any of the following investments specified in Part III of the Regulated Activities Order:

(a) shares (article 71);

(b) debentures (that is, instruments creating or acknowledging indebtedness) (article 72);

(c) government and public securities (article 73);

(d) warrants (that is, instruments giving entitlement to investments) (article 74);

- (e) certificates representing certain securities (article 75);
- (f) options (article 77); for the purposes of the permission regime, these have been sub-divided into:
 - (i) options (excluding commodity options and options in commodity futures);
 - (ii) commodity options and options on commodity futures;
- (g) futures (article 78); for the purposes of the permission regime, these have been sub-divided into:
 - (i) futures (excluding commodity futures);
 - (ii) commodity futures;
- (h) contracts for differences (article 79); for the purposes of the permission regime, these have been sub-divided into:
 - (i) contracts for differences (excluding spread bets and rolling spot forex contracts);
 - (ii) spread bets;
 - (iii) rolling spot forex contracts;
- (i) rights to or interests in an investment in (a) to (h) (article 83).

<i>investment</i>	as defined in section 22(4) of the <i>Act</i> (The classes of activity and categories of investment): any <i>investment</i> , including any asset, right or interest.
<i>investment firm</i>	any legal <i>person</i> the regular occupation or business of which is the provision of <i>core investment services</i> for third parties on a professional basis, as defined in article 1(2) of the Investment Services Directive, and any person, who is not a legal person, included as an investment firm by his or its Home State.
<i>market abuse</i>	<i>behaviour</i> defined by section 118(1) of the <i>Act</i> .
<i>market counterparty</i>	a client who is: <ul style="list-style-type: none"> (a) a properly constituted government (including a quasi-governmental body or a government agency) of any given country or territory; (b) a central bank or other national monetary authority of any country or territory; (c) a supranational whose members are either countries or central banks or national monetary authorities; (d) a State investment body, or a body charged with, or intervening in, the management of the public debt; (e) another firm, or an overseas financial services institution, except: <ul style="list-style-type: none"> (i) if that firm or institution is a collective investment scheme; or (ii) in relation to designated investment business, and related ancillary activities, conducted with or for that firm or institution, when that firm or institution is an intermediate customer in accordance with COB 4.1.7R (Classification of another firm or an

overseas financial services institution);

(f) any associate of a firm (except an OPS firm), or of an overseas financial services institution, if the firm or institution consents;

(g) a client when he is classified as a market counterparty in accordance with COB 4.1.12R (Large intermediate customer classified as a market counterparty);

but (except for the purposes of DISP) excluding a client, who would otherwise be a market counterparty, when he is classified as a private customer in accordance with COB 4.1.14R (Client classified as private customer).

money

any form of money, including cheques and other payable orders.

name-passing broker

a *person* who arranges deals between counterparties at mutually acceptable terms and passes their names to each of them to facilitate the conclusion of a transaction;

non-directive friendly society

see CP 41A.

(1) a friendly society whose insurance business is restricted to the provision of benefits which vary according to the

resources available and in which the contributions of the members are determined on a flat-rate basis;

(2) a friendly society whose long-term insurance business is restricted to the provision of benefits for employed and self-employed persons belonging to an undertaking or group of undertakings, or a trade or group of trades, in the event of death or survival or of discontinuance or curtailment of activity (whether or not the commitments arising from such operations are fully covered at all times by mathematical reserves);

(3) a friendly society which undertakes to provide benefits solely in the event of death where the amount of such benefits does not exceed the average funeral costs for a single death or where the benefits are provided in kind;

(4) a friendly society (carrying on long-term insurance business):

(a) whose registered rules contain provisions for calling up additional contributions from members or reducing their benefits or claiming assistance from other persons who have undertaken to provide it; and

(b) whose annual gross premium income (other than from contracts of reinsurance) has not exceeded euro 500.000 for each of the three preceding financial years;

(5) a friendly society (carrying on general insurance business) whose:

(a) registered rules contain provisions for calling up additional contributions from members or reducing their benefits; and

(b) gross premium income (other than from contracts of reinsurance) for the preceding financial year did not exceed euro 1,000,000;

(6) a friendly society whose liabilities in respect of general insurance contracts are fully reinsured with or guaranteed by other mutuals (including friendly societies); and

(7) a friendly society which does not have permission to effect or carry out contracts of insurance.

and in this definition, "mathematical reserves", "gross premium" and "reinsured" have the meanings given in IPRU(FSOC).

non-directive insurer

has the meaning given in IPRU(INS).

non market price transaction

a transaction where

(a) the *dealing* rate or price paid by the firm or its *market counterparty* differs from the prevailing market rate or price to a material extent; or

(b) the *firm* or its *market counterparty* otherwise gives materially more or less in value than it receives in return.

on exchange

(1) (in relation to a transaction in the United Kingdom) effected by means of the facilities of, or governed by the rules of, an RIE, an ROIE or a regulated market.

(2) (in relation to any other transaction) effected by means of the facilities of, or governed by the rules of, an exchange.

operator

(a) in relation to an AUT, the manager;

(b) in relation to an ICVC, that company or, if applicable, the authorised corporate *director*;

(c) in relation to an unregulated *collective investment scheme* that is a unit trust scheme with a separate trustee, any *person* who, under the trust deed establishing the scheme, is responsible for the management of the property held for or within the scheme;

(d) in relation to any other unregulated *collective investment scheme*, any *person* who, under the constitution or founding arrangements of the scheme, is responsible for the management of the property held for or within the scheme; and

(e) in relation to an investment trust savings scheme, any *person* appointed, by those responsible for managing the property of the investment trust, to manage the investment trust savings scheme.

<i>option</i>	the investment specified in article 77 of the Regulated Activities Order (Options), which is an option to acquire or dispose of: (a) a security or contractually based investment (other than an option); (b) currency of the United Kingdom or of any other country or territory; (c) palladium, platinum, gold or silver; or (d) an option to acquire or dispose of an option specified in (a), (b) or (c).
<i>overseas financial services institution</i>	an institution authorised in an EEA State other than the United Kingdom by a competent authority, or in any other country or territory by a regulatory body which is a member of IOSCO.
<i>permission</i>	<i>permission</i> given by <i>the FSA</i> under Part IV of <i>the Act</i> , or resulting from any other provision of <i>the Act</i> , to carry on <i>regulated activities</i> in the <i>United Kingdom</i> ;
<i>person</i>	a legal or natural person, including an individual, a body corporate and a body of legal or natural persons, such as an unincorporated association or a partnership.
<i>principal</i>	(1) in relation to a person: (a) a person acting on his own account; (b) (where the person is an appointed representative) the authorised person who is party to a contract with the appointed representative resulting in him being exempt under section 39 of the Act (Exemption of appointed representatives). (2) in relation to an amount: (a) (except where the amount relates to an option or a future) the amount of property or the value of the property which must be delivered in order to satisfy settlement of a derivative; (b) (in relation to an option on a future) the amount of property or the value of the property which must be delivered in order to satisfy the settlement of a future.
<i>Principle</i>	one of the Principles set out in PRIN 2.1 (Principles for Businesses).
<i>private customer</i>	a client who is not a market counterparty or an intermediate customer, and including: (a) an individual who is not a firm; (b) an overseas individual who is not an overseas financial services institution; (c) a regulated collective investment scheme (or, if that scheme is a unit trust scheme, its trustees); and (d) (except for the purposes of DISP) a client when he is classified as a private customer in accordance with COB 4.1.14R (Client

classified as a private customer);

but (except for the purposes of DISP) excluding a client, who would otherwise be a private customer, when he is classified as an intermediate customer in accordance with COB 4.1.9R (Expert private customer classified as an intermediate customer).

Regulated Activity Order (RAO)

The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001;

regulated activity

(in accordance with section 22 of the Act) each of the following activities in the Regulated Activities Order which is carried on by way of business:

- (a) accepting deposits (article 5);
- (b) effecting contracts of insurance (article 9(1));
- (c) carrying out contracts of insurance (article 9(2));
- (d) dealing in investments as principal (article 12);
- (e) dealing in investments as agent (article 19);
- (f) arranging (bringing about) deals in investments (article 22(1));
- (g) making arrangements with a view to transactions in investments (article 22(2));
- (h) managing investments (article 33);
- (i) safeguarding and administration of assets (article 36); for the purposes of the permission régime, this is sub-divided into:
 - (i) safeguarding and administration of assets;
 - (ii) arranging safeguarding and administration of assets;
- (j) sending dematerialised instructions (article 42(1));
- (k) causing dematerialised instructions to be sent (article 42(2));
- (l) establishing, operating or winding up a collective investment scheme (article 48(1)(a)); for the purposes of the permission régime, this is sub-divided into:
 - (i) establishing, operating or winding up a regulated collective investment scheme;
 - (ii) establishing, operating or winding up an unregulated collective investment scheme;
- (m) acting as trustee of an authorised unit trust scheme (article 48(1)(b));
- (n) acting as the depository or sole director of an open-ended investment company (article 48(1)(c));
- (o) advising on investments (article 49); for the purposes of the permission régime, this is sub-divided into:
 - (i) advising on investments (except on pension transfers and pension opt-outs);
 - (ii) advising on pension transfers and pension opt-outs;
- (p) advising on syndicate participation at Lloyd's (article 52);
- (q) managing the underwriting capacity of a Lloyd's syndicate as a managing agent (article 53);
- (r) arranging deals in contracts of insurance written at Lloyd's (article 54);
- (s) entering as provider into a funeral plan contract (article 55);
- (t) agreeing to carry on a regulated activity (other than (a), (b), (c),

(l), (m) or (n)) (article 59).

<i>rule</i>	as defined in section 417(1) of the <i>Act</i> (Definitions), a rule made by the <i>FSA</i> under the <i>Act</i> .
<i>security</i>	<p>the following <i>investments</i> as more fully specified in the <i>Regulated Activities Order</i>:</p> <ul style="list-style-type: none">(a) shares (article 71);(b) instruments creating or acknowledging indebtedness (article 72);(c) government and public securities (article 73);(d) instruments giving entitlement to <i>investments</i> (article 74);(e) certificates representing certain securities (article 75);(f) units in a <i>collective investment scheme</i> (article 76); and(g) rights to or interests in <i>investments</i> so far as relevant to any of those <i>investments</i> (article 83).
<i>service company</i>	<p>a <i>firm</i>:</p> <ul style="list-style-type: none">(a) whose sole permitted activity is arranging deals in investments;(b) whose permission incorporates a limitation that this activity be carried on solely for <i>market counterparties</i> or <i>intermediate customers</i>;(c) which does not guarantee or otherwise accept responsibility for the performance by any of its <i>market counterparties</i> or <i>intermediate customers</i> of obligations undertaken by those <i>market counterparties</i> or <i>intermediate customers</i> in connection with transactions arranged or settled under the facilities provided by the <i>firm</i>; and(d) whose permission includes requirements that it must not approve any financial promotion on behalf of any other person; or provide services to a <i>customer</i> otherwise than in the terms set out in the documents previously shown to the <i>FSA</i> (whether in the form of rules, regulation, operating procedures, agreements or otherwise) which are stated by the <i>firm</i> to be documents containing the terms under which it will provide services for its <i>customers</i>.
<i>sole trader</i>	an individual who is a <i>firm</i> ;
<i>transaction-specific advice</i>	<p>advice</p> <ul style="list-style-type: none">(1) given in connection with activities carried on by the firm that falls within MAR 3.1.2(2)R(a) or R(b); or(2) with a view to carrying on any such activities <p>with or for the <i>market counterparty</i> to whom the advice is given.</p>

<i>UCITS qualifier</i>	<p>a <i>firm</i> which:</p> <p>(a) for the time being is an operator, trustee or depositary of a recognised collective investment scheme; and</p> <p>(b) is an authorised person as a result of paragraph 1(1) of Schedule 5 (Persons Concerned in Collective Investment Schemes) to the Act;</p> <p>a reference to a <i>firm</i> as a UCITS qualifier applies in relation to the carrying on by the <i>firm</i> of activities for which it has permission in that capacity.</p>
<i>undertaking</i>	<p>as defined in section 259 of the Companies Act 1985:</p> <p>(a) a body corporate or partnership; or</p> <p>(b) an unincorporated association carrying on a trade or business, with or without a view to profit.</p>
<i>unit</i>	<p>(as specified in article 76 of the Regulated Activities Order) the right or interest (however described) of the participants in a collective investment scheme; this includes:</p> <p>(a) (in relation to an AUT) a unit representing the rights or interests of the unitholders in the AUT;</p> <p>(b) (in relation to an ICVC) a share in the ICVC.</p>
<i>United Kingdom</i>	<p>England and Wales, Scotland and Northern Ireland, but not the Channel Islands or Isle of Man;</p>
<i>UK domestic firm</i>	<p>a <i>firm</i> that has its registered office (or if it does not have a registered office, its head office) in the <i>United Kingdom</i>;</p>
<i>venture capital contact</i>	<p>(when a firm carries on designated investment business with or for a person in the course of or as a result of carrying on venture capital business) that person in connection with that designated investment business if:</p> <p>(a) the firm does not behave in a way towards that person which might reasonably be expected to lead that person to believe that he is being treated as a client; and</p> <p>(b) the firm clearly indicates to that person that the firm:</p> <p>(i) is not acting for him; and</p> <p>(ii) will not be responsible to him for providing protections afforded to clients of the firm or be advising him on the relevant transaction.</p>
<i>wholesale market broker</i>	<p>a firm when carrying out the activities of <i>name-passing broker</i> or acting on a matched principal basis with or for <i>market counterparties</i>;</p>