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Article 4 introduces a "flexibility" clause which derogates from the overall objective of the MiFID to ensure a level playing field for firms and an equal investor protection level throughout the EU. In order to make sure that this clause does not become the back door for introducing "gold-plating", following conditions need to be respected:

- Article 4 of the Level 2 Directive is a derogation to the extensive harmonisation approach; like all derogations it should be interpreted in the most restrictive manner;*
- Article 4 cannot be used by Member States in order to derogate from or modify the principles set in the Level 1 Directive; any additional requirements to those included in the Level 2 Directive should still be in line with the main principles established in the Level 1 Directive.*

Response by the Irish Financial Regulator:

The Client Money Rules proposed by the Irish Financial Regulator effective from 1 November 2007 include a carve out of the relevant MiFID requirements and therefore are not used to derogate from or modify the principles set out in the Level 1 Directive or the requirements contained in the Level 2 Directive.

Additionally as detailed in the attached mapping many of the current requirements that are being maintained constitute guidance on the definition of clients assets, best practice procedures or guidance on the applicability of the client money rules, the spirit of which is represented in the MiFID Level 1 principles and Level 2 requirements. Therefore many of the requirements that appear to be additional to the proposed MiFID requirements are in fact in line with the main principles established in the Level 1 and the Level 2 Directives and the Irish Financial Regulator considers that it is necessary to explicitly set out these requirements in order to ensure the practical implementation of the client money rules.

Full details of those elements of the current client money requirements that are being maintained and that the Irish Financial Regulator considers constitute guidance and/or best practice are detailed in the attached document.

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It is true that Member States have a margin of discretion when transposing a directive; this is also valid for Directive 2006/73/EC. In this context, national measures which do not amplify the obligation set by the Level 2 Directive could still be considered in line with this Directive, thus not necessarily establishing additional obligations. The Commission services are in favour of an intelligent copy out for the transposition of tightly worded directives providing for extensive harmonisation; however, they admit that Member States always remain free to choose the means for achieving the objectives set in such a legislative text. On the other hand, it should be born in mind that the MiFID level 2 reinforces the duties and the responsibility of the firms as well as the duties of the supervisors, thus limiting the choices that Member States are allowed to make when transposing the MiFID. The MiFID establishes for firms a series of obligations of result – which they should fill under a reinforced supervisory framework. Thus, any additional rules that limit the choices to be made by the firm should be adequately justified (see below under point 3) and preferably imposed in the form of interpretative guidance and not in the form of binding rules¹.

- It is clear that any additional requirements should only be imposed to firms that are subject to the authorisation and supervision of the Member State which imposes these requirements. To this end, firms operating on a provision of services basis as well as branches for all the aspects which are not included in Article 32 (7) of the Level 1 Directive should not be subject to any additional requirements by the host competent authority.

Response by the Irish Financial Regulator:

The Client Money Rules are only applicable to those firms that will be authorised under the MiFID Regulations and on whom they have been specifically imposed by the Irish Financial Regulator. Therefore they will not be imposed on an entity passporting into Ireland who holds client money. Such entities will however be required to comply with the provisions of the MiFID regarding the safekeeping of client assets.

¹ See recitals 11 and 12 of the Implementing Directive.

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3. Conditions justifying a derogation under Article 4

In terms of substance:

Paragraph 1 of Article 4 of the Level 2 Directive provides for a series of factors that need to be present in order for the derogation to be permissible:

- The derogation should only be used in exceptional cases i.e. where the provisions of the Directive are not adequate in order to address specific risks related to investor protection or market integrity;

Response by the Irish Financial Regulator:

The Irish Financial Regulator considers that the existing requirements, to receive certain formal confirmations from third parties with whom client assets are held; as to the manner in which the client assets will be held; as well as the requirement to complete a daily client money calculation to ensure the investment firm is holding as much client money as it should be holding among others, are necessary in order to address specific risks related to investor protection or market integrity. Full details regarding those elements of the current client money requirements which are considered necessary in order to address specific risks related to investor protection or market integrity are set out in Appendix II.

In addition, although not specifically required the Irish Financial Regulator has set out in Appendix III those existing client money rules which it considers are necessary to safeguard clients' rights for reasons of the applicable law relating to property or insolvency (Article 16(2) of the Implementing Directive). These existing rules include those relating to segregation of client assets and/or the requirements surrounding the pooling of client assets and the rules governing set off arrangements put in place in addition to those client money rules relating to the safekeeping of client financial instruments and the registration and recording of such financial instruments.

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- The measures taken by the Member State should be objectively justified and proportionate to address these risks;

Response by the Irish Financial Regulator:

Objective justification for the retention of these rules, many of which have arisen in light of jurisprudence arising from recent insolvencies, has been included in Appendix II & III. In summary the Irish Financial Regulator considers that certain requirements are necessary in order to ensure the client is adequately informed and that the client's beneficial interest in the assets is maintained. Additionally the requirements regarding formal confirmations ensures that the third party to whom client assets are passed will comply with the provisions of the client money rules. The requirement to produce a daily calculation is justified as it ensures that there is sufficient money in client bank accounts to pay monies owing to clients.

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- The specific risks are of particular importance in the market structure of that Member State.

Response by the Irish Financial Regulator:

As detailed in Appendix II and III many of the specific current client money rules, specifically those relating to segregation of client assets, pooling of client assets, the use of set off agreements and the requirement to produce a daily calculation arose in light of jurisprudence arising from recent investment firm insolvencies.

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The notification needs to include a justification which conforms to the strict criteria set in paragraph 1 of this Article.

Response by the Irish Financial Regulator:

Appendix II sets out each client money requirement which the Irish Financial Regulator is proposing to maintain under Article 4 of the Implementing Directive in turn followed by a justification for that specific requirement.

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On the other hand, we are conscious that market integrity and investor protection are prevailing objectives.

Response by the Irish Financial Regulator:

Article 16(2) of the Level 2 Directive provides that if, for reasons of the applicable law in the Member State relating to property or insolvency, the arrangements made by investment firms to safeguard clients' rights, as set out in Article 16 of the Implementing Directive, are considered insufficient Member States shall prescribe the measure that investment firms must take in order to comply with this requirement.

In this regard the Irish Financial Regulator has also identified those elements of the current client money requirements which it considers necessary in order to safeguard clients' ownership and property rights and therefore to uphold market integrity and investor protection. These requirements are identified in the attached mapping document and are set out in detail in Appendix III.