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By email: cp16-29@fca.org.uk

4 January 2017

Dear Sirs

CP16-29 – FCA Consultation on MiFID II implementation (Consultation Paper III)

The City of London Law Society ("**CLLS**") represents approximately 17,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi-jurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

This letter has been prepared by the CLLS Regulatory Law Committee (the "**Committee**"). The Regulatory Committee not only responds to consultations but also proactively raises concerns where it becomes aware of issues which it considers to be of importance in a regulatory context.

We welcome the opportunity to respond to the proposals set out in Chapters 2, 3, 15 and 17 of this consultation paper.

Chapter 2 – Inducements, including adviser charging

Q2. Do you agree with our proposal to apply the MiFID II inducement rules for independent advice to all advice provided to retail clients?

The substance of paragraphs 2.24 to 2.26 that precede Q2 ask whether the MiFID II commission ban should be extended to restricted advice (not just independent advice) when given to retail clients. We do not express a view on this aspect, but wish to highlight a point in relation to extra-territorial scope. The FCA is proposing to implement the above as follows:

- the RDR Rules will apply to advisers in relation to RIPs specifically; and

- COBS 2.3A will apply the MiFID II inducements ban to independent/restricted advisers more generally.

The issue we wish to highlight is that the RDR Rules only apply where the advice is given to retail clients in the UK. We note that neither COBS 2.3A nor the application section in COBS 1 appear to include this same territorial scope restriction. This proposal will, therefore, have the consequence of having advice in relation to non-MiFID scope RIPs be subject to the UK's gold-plated ban in the RDR Rules when advice is given to retail clients in the UK only. However, the UK's gold-plated MiFID II ban in COBS 2.3A will apply when advice is given to retail clients wherever they may be located. This UK-specific extension of the MiFID II ban will, therefore, apply to UK firms operating cross border into another EEA member state and to EEA branches of UK firms relying on the UK firm's services passport. Given that the FCA is gold-plating this element of MiFID II, we would query why the FCA is not limiting the scope of this gold-plating to where advice is provided to retail clients in the UK (as is the case in the RDR Rules).

Q3. Do you agree with our proposal to ban firms providing advice or portfolio management services to retail clients from receiving and rebating monetary benefits to such clients?

First, we would repeat our response in Q2 to this question on the extra-territorial impact of this UK-specific gold-plating aspect of MiFID II implementation. We would query whether, given that the proposed gold-plating is UK-specific, it should be limited to where the activity (advisory services/portfolio management services) is being provided to retail clients in the UK (for advisory services) or for the benefit of retail clients located in the UK (for portfolio management).

For instance, as COBS requirements are a home state matter for firms providing their services cross border (without a branch) or for EEA branches relying on the UK firm's services passport to provide services into another (third) EEA Member State, the FCA's current proposals would mean that UK firms providing advisory services to non-UK clients will be in an uncompetitive position to their non-UK counterparts providing the same advisory services to the non-UK clients to the extent non-UK counterparts are able to offer a rebate to customers, whilst the UK firms are not.

Second, we wish to highlight to the FCA that for those instruments which are both RIPs and MiFID II financial instruments and in relation to firms that provide advisory services, it is not yet clear whether COBS 6.1A or COBS 2.3A takes precedence (see paragraph 2.35). Both of these chapters contain different exclusions/carve-outs for certain permitted payments so it would be helpful to understand which standard a firm is to apply. For example, COBS 2.3A only applies to the actual advisory service offered whereas COBS 6.1A also applies to 'related services' to the advisory service and to payments being received by affiliated firms to the advisory firm which COBS 2.3A does not.

Q4. Do you consider that the ban on receiving and rebating monetary benefits to clients should also apply to professional clients?

We would repeat our comments from the response to Q2 in relation to the presumably unintended extra-territorial impact of the current COBS 2.3A.

Q6. Do you agree with our proposal to extend the MiFID II limitation on non-monetary benefits to the wider business of providing advice in respect of RIPs? And Q7. Do you think we should extend the MiFID limitation on non-monetary benefits to the wider business of providing advice for all MiFID products, and not just RIPs.

We have a number of comments to make in relation to these two questions.

Extending the RDR Rules to apply to the wider business of providing advisory services in relation to RIPs

Paragraph 2.36 states that the FCA wishes to extend the existing UK RDR rules to all advisory services of UK firms (who deal with retail clients), not just to those advisory services that include a personal recommendation. We wish to draw the FCA's attention to the items set out below.

First, as the FCA will know, the UK government is currently consulting on amending the regulated activity of 'advising on investments' to match more closely the MiFID II definition of investment advice which is, essentially, a personal recommendation. The change proposed by the FCA would mean that UK independent and restricted advisory businesses would need to apply the stricter, gold-plated RDR Rules to all aspects of their wider advisory businesses (including those parts of their businesses that do not involve a personal recommendation) for a period of time before the UK Government's change takes effect (if it proceeds) to bring these firms back in line with the MiFID II investment advisory scope.

We would query whether it is sensible or proportionate to put UK businesses (which have already had to amend their practices to implement the RDR Rules) through two changes: (i) to implement the stricter RDR Rules to the entirety of their advisory businesses to then (ii) undo the restriction on their advisory businesses (excluding those business lines that provide personal recommendations) once (if) the UK Government's proposed change to the regulated activity takes effect.

Second, to be consistent with the FCA's stated intention, COBS 2.3A.2G(1) would need to be amended as it still refers to 'personal recommendation'.

In addition, the extra-territorial scope issues highlighted in our response to Q2 (i.e. when the retail client is in the UK or not in the UK) will also apply additional complexity to the above scenarios.

Extending the MiFID II limitation on non-monetary benefits to apply to the wider business of providing advisory services in relation to MiFID II financial instruments

See our response above, in particular the extra-territorial scope issues.

If the FCA proceeds with this consultative aspect, we note that COBS 2.3A.11R and COBS 2.3A.12R would need to be further amended as the current drafting (reference to 'independent advice' and 'restricted advice') does not implement this aspect.

Amending the RDR Rules so only permitted minor non-monetary benefits can be received

The only item we wish to raise on this aspect is whether, in introducing this change, the FCA will make it clear that currently permitted legacy payments under the RDR Rules will need to cease.

Chapter 3 – Inducements and research

Q9: Do you agree with our approach to transpose the MiFID II proposals for the receipt of research linked to the new MiFID II inducement rules as a new COBS 2.3B?

We do agree with the FCA's approach to transpose MiFID II proposals for the receipt of research linked to the new MiFID II inducement rules as a new COBS 2.3B. We set out below a number of additional points that we wish to raise in relation to the FCA's implementation of these requirements.

Client money considerations

We note that, pursuant to COBS 2.3B.15G and in line with CASS 7.25.11R, RPA funds do not in the FCA's view constitute client money. However, we believe it would be helpful for firms if the FCA were to clarify how excess money in an RPA should be treated – and, specifically, if the FCA were to explicitly confirm the understanding generally held in the investment management industry that such funds only become client money at the point at which they are rebated to the relevant fund or client (and not before).

Research payments to non-EU brokers

We also note that a number of complex issues arise out of some of the cross-border implications of the MiFID II requirements related to inducements and research. For example, in relation to UK investment managers' relationships with US broker-dealers, we note that it is unclear whether a US broker-dealer could accept a payment for research from an RPA and remain exempt from registration as an investment adviser under the US Investment Advisers Act of 1940.

We consider it important the FCA, ESMA and the European Commission works with the SEC and any other relevant overseas regulatory bodies to address this issue and similar issues arising in relation to other non-EU jurisdictions. To the extent firms are ultimately required to establish particular operational structures in order to achieve compliance with potentially conflicting sets of rules, it would be helpful for the FCA to state explicitly that such structures are permitted.

Mixed use services

Under the current provisions on use of dealing commissions the FCA recognises that some goods or services may have mixed use, including use as substantive research (i.e. within the scope of the new definition of "research"), and thus a permissible element. The current provisions recognise that, as a consequence, managers are permitted to allocate an appropriate value to include as a permissible charge under the restrictions on the use of dealing commission (in particular COBS 11.6.8A), and provides assistance on how managers should approach this. We do not understand the MiFID II restrictions to prohibit clients from paying for qualifying research which is supplied in the form of a mixed use service, and we did not read the FCA's CP as suggesting that this was the intention. Allowing clients to purchase research in this way should help to ensure investment managers have access to the widest possible sources of research for their clients. That being so, we suggest that it would be appropriate (and of assistance to portfolio managers and others) if the elements of COBS 11.6.8A relating to the proper allocation of a mixed use service charge were retained.

Chapter 15 - Recording of telephone conversations and electronic communications (taping)

In response to questions 54 and 57, we question whether it is necessary and proportionate to apply to non-MiFID firms the enhanced requirements for the recording of telephone conversations and electronic communications which include a potentially onerous requirement to retain such recordings for 5 years.

For example, in relation to corporate finance business, the FCA acknowledges in paragraph 15.21 of the commentary that certain corporate finance activities, such as advice and underwriting, will not fall within Article 16(7) of MiFID 2. The FCA indicates that it considers this to create a potential gap in taping in relation to corporate finance business.

While it is acknowledged that some corporate finance firms routinely have access to inside and confidential information, to the extent that this is the case, such corporate finance firms are already required to comply with the Market Abuse Regulation and, in the course of any market soundings, and in relation to the maintenance of insider lists, are subject to related record keeping requirements.

We understand that the FCA takes the view that the costs of adhering to the taping requirements are likely to be small. However, we do not consider this will necessarily be the case for all of those firms that have hitherto not been subject to any taping requirement. We hope that the FCA will take this into account in determining whether the proposed requirements are necessary and proportionate if applied to firms which are not in fact within scope of this element of the directive, and will also reflect in its considerations the impact of imposing more onerous taping and retention requirements than are found in COBS11.8 on those who are already subject to taping requirements.

Chapter 17 – Perimeter Guidance (with Appendix 1, Annex O)

We note from the commentary in Chapter 17 that the FCA's proposals for PERG are based on the wording of the proposed implementing legislation set out in the HM Treasury consultation document of March 2015. We cannot tell from the CP whether the FCA has raised the possibility of deleting Article 24B(2) of the RAO with HM Treasury, but that is clearly more appropriate than introducing the proposed PERG 2.7.6B(4), and we consider that HM Treasury should address the matter directly.

As an overall observation, we note that the Q&A approach for MiFID II perimeter guidance in the draft PERG material is in a number of places very difficult to follow because of the length of some of the answers. Although we recognise that this follows an existing practice of Q&A, we suggest that the FCA reconsider this approach when seeking to explain its understanding of the complexities of the regulatory perimeter.

The narrative approach in PERG 2 contrasts with PERG 13's Q&A, and on complex issues is somewhat easier to follow, in part because the explanations are broken up in a way that permits ready referencing to the comments most pertinent to the issue in hand. Alternatively, the FCA should consider breaking up those answers that are very long, by extracting key elements for separate Q&A. By way of a particular example, we consider the answer to Q31C could be made easier to follow by extracting material on "What is a 'business day' for these purposes?" and "What are 'major currencies'?". We suggest that the FCA review each of the long answers and break them down so as to simplify the commentary for a less sophisticated reader. If it would be of assistance, the Committee would be happy to work with the FCA to assist in breaking down some of the lengthier Q&A responses in this section of PERG.

We also suggest that the FCA takes care in references to "use of the internet". Such use can take a number of forms – notably operation of websites accessible via the internet, and the sending of emails. Accordingly the guidance in the last sentence of 13.3, Q.20 should distinguish more expressly between the use of the internet by using websites (which may be addressed to the public in general and therefore not be personal) and email, for example by commenting "*Therefore, for instance, while advice through a generally accessible website is unlikely to be a personal recommendation, an email communication provided to a specific person, or to several persons, may amount to investment advice.*"

Finally we note that the draft PERG 1.5.1(13) contains a typographical error – the hyperlink should, we think, read "https://www.fca.org.uk/publication/finalised-guidance/fg15-01.pdf". (The current draft omits a "d" from "finalised".)

If you would find it helpful to discuss any of these comments then we would be happy to do so. Please contact Karen Anderson by telephone on +44 (0) 20 7466 2404 or by email at Karen.Anderson@hsf.com in the first instance.

Yours faithfully

Karen Anderson
Chair, CLLS Regulatory Law Committee

THE CITY OF LONDON LAW SOCIETY
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