The City of London Law Society

4 College Hill
London EC4R 2RB

Tel +44 (0)20 7329 2173
Fax +44 (0)20 7329 2190
DX 98936 – Cheapside 2

mail@citysolicitors.org.uk

www.citysolicitors.org.uk

MiFID Coordination
Markets Policy Department
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

By email: cp16-43@fca.org.uk

20 February 2017

Dear Sirs

CP 16-43 – Markets in Financial Instruments Directive II Implementation – Consultation Paper IV

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 and 3 of this consultation paper.

Chapter 2 – Specialist regimes

We have several concerns about the FCA's proposals in relation to Energy Market Participants ("**EMPs**"), Oil Market Participants ("**OMPs**") and firms conducting other non-MiFID commodity (and exotic) derivatives business. These centre on the issue of taping.

In our response of 4 January 2018 to CP16/29, we took issue with the FCA's proposals to extend taping thus: "*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.*"

We now not only repeat the same point in relation to the CP16/43 proposal to extend the recording requirement to non-MiFID business related to commodity or exotic derivatives, but would question the process by which the FCA has developed these proposals.

In both CP16/29 and CP16/43, the FCA has made assumptions about the costs of taping without producing evidence or any detail of the 'research' referred to in paragraph 325 of the CP16/29 Cost Benefit Analysis ("**CBA**") in relation to Non-Directive Firms – that and other paragraphs of the CP16/29 CBA are referred to in seeking to justify the further extension of taping to non-MiFID commodity/exotic derivatives business. The FCA should produce clearer evidence of costs to be weighed against the supposed benefits of imposing MiFID II taping standards on non-MiFID business that is already subject to a taping requirement. Whilst those benefits may not be quantifiable, the benefits described in paragraphs 336-339 of the CP16/29 CBA (and referred to in paragraph 14 of the CP16/43 CBA) are merely benefits of taping – for example, the self-disciplining effect of calls being taped – or use in supervision and enforcement. The emphasis was in other areas of business – e.g. retail, corporate finance.

No justification is provided for an increase in the retention period from six months under the current domestic regime to the five years proposed to align with MiFID II. We accept that "*market abuse has significant detrimental impacts on financial markets*" and "*the taping regime is a valuable means of gathering evidence in the context of market abuse and related regulatory breaches*" (from paragraph 314 of CP16/29 CBA and paragraph 15.3 of CP16/29 itself). However these are not arguments which justify an increase in the retention period for firms outside the scope of MiFID II: a case would need to be made that the increase would significantly enhance supervisory and enforcement outcomes. If a longer period is so valuable, it is surprising that the FCA should have waited until now to increase it. The consultation papers create the impression that the proposal is driven to a significant degree by a desire for simplicity and consistency without sufficient identification of the costs involved.

The FCA has not made clear why the longer period is needed, and we note that in almost all cases the FCA will have access to records created under MiFID II or MAR.

That the taping regime is "*relevant to the activities of non-MiFID firms*" (paragraph 15.3 of CP16/29) is not of itself sufficient to justify extending the MiFID II regime to such firms. The FCA has not made the case that it is proportionate to do so. For example:

- The FCA has not explained why the records of firms conducting MiFID II business, records kept under the Market Abuse Regulation (MAR) and the exercise by the FCA of its investigatory powers (under MAR and domestic legislation) are insufficient. Are there a significant number of situations which would fall outside that net so as to require the application of MiFID II taping to non-MiFID commodity/exotic derivatives business?

- The FCA states that "[*w*]*e do not expect that implementing these measures will be overly resource intensive or costly for these firms, as they are likely to be standard market practice*" – yet has produced no evidence to support such expectations.

We note also in passing that the record keeping requirements for client communications (confirmations and statements) under COBS 16.2.7R and COBS 16.3.11R are being left at three years rather than the MiFID requirement of five years.

Finally, we would note flaws in the consultation process in this area in CP16/29 have been repeated in CP16/43, namely misleading chapter headings. In both consultation papers, the existence of key proposals in relation to non-MiFID commodity/exotic derivatives business (and in CP16/29, in relation to EMPs and OMPs) are concealed by the "Who should read this chapter" description at the start of the relevant chapter.

In CP16/43, the chapter description refers to EMPs/OMPs whereas the chapter contains critical proposals in respect of other commodity/exotic derivatives business which may not be carried on by EMPs/OMPs. At least the chapter title provides an indication that COBS 18 rules may be at issue.

However, in CP16/29, the approach was more misleading. Chapter 15 on taping was described (in the "Who should read this chapter" box) as for "*Firms conducting MiFID or equivalent third country business, Article 3 firms and non-MiFID Investment managers*" and "*Consumers and consumer organisations*". Unlike Chapter 11 ("*Investment research*" which referred also to "*certain firms undertaking non-MiFID business*",[1] there was no mention of non-MiFID business, EMPs, OMPs, or commodity or exotic business. Furthermore, there is no recognition that the application of COBS 18.2.1R through COBS 18.2.4R extends to energy and oil market business, not just to EMPs and OMPs.

Since CP16/43 piggy-backs so extensively on the consultation in CP16/29, we consider that both are flawed in relation to proposals for energy and oil market business, and other commodity/exotic business. We would suggest that the FCA should consider a further consultation on taping targeted specifically at non-MiFID firms, including those engaged in energy and oil market activity and commodity/exotic derivatives business.

In conclusion, we would urge the FCA to reconsider whether the proposed requirements are necessary and proportionate. In order to ensure that it can take into account information and views from as broad a selection as possible of those most affected by its proposals to apply MiFID II taping requirements to non-MiFID firms, we suggest that the FCA seek to re-consult in a fashion which is specifically directed to the community who would be affected by implementation of the potentially onerous proposal.

Chapter 3 – Tied agents

We are concerned about the risk of mismatch in the timing of implementation of MiFID II in different Member States. In particular we are concerned that a situation may arise in which a UK firm wishes to appoint a tied agent in another EU member state, which does not currently have a tied agent regime and which is late in introducing such a regime. The proposed changes to SUP 12 would mean that it would not be possible for an FCA authorised firm to appoint a new tied agent in those jurisdictions and existing appointments might also be impacted.

We suggest that it would be helpful to include transitional provisions to permit the registration with the FCA of a tied agent established in another EU member state until the relevant EU member state has fully implemented MiFID II in relation to the registration of tied agents established in its territory.

[1] Note that, similarly, the "Who should read this chapter" box in Chapter 4 (Client categorisation) mentioned "*firms conducting non-MiFID business*".

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
REGULATORY LAW COMMITTEE

Individuals and firms represented on this Committee are as follows:

Karen Anderson (Chair, Herbert Smith Freehills LLP)
Matthew Baker (Berwin Leighton Paisner LLP)
Peter Bevan (Linklaters LLP)
Margaret Chamberlain (Travers Smith LLP)
Simon Crown (Clifford Chance LLP)
Richard Everett (Travers Smith LLP)
Robert Finney (Holman Fenwick Willan LLP)
Angela Hayes (King & Spalding International LLP)
Jonathan Herbst (Norton Rose Fulbright LLP)
Mark Kalderon (Freshfields Bruckhaus Deringer LLP)
Etay Katz (Allen and Overy LLP)
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