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

Stephen Hanks
The Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

By email: stephen.hanks@fca.org.uk

29 December 2017

Dear Mr Hanks

MiFID II – Outsourcing in relation to Portfolio Management Services

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 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 write to provide you with some observations on your letter of 19 July 2017 addressed to Mr Jiří Krol of AIMA.

We are grateful for the confirmation that the European Commission Q&A on MiFID remains a continuing source of useful legal interpretation of the MiFID I and II outsourcing provisions. We therefore agree with FCA that, when delegating the performance of a function, an investment firm should seek to ensure that it is not in conflict with its obligations to act in the best interests of its relevant clients.

We note FCA's view that, in applying this principle, and the provisions of Article 31 of the MiFID II Delegated Regulation, to the new inducements framework for portfolio managers, a purposive reading of that framework is necessary. Our view is that the FCA is correct when it

says that "*the firm will need to take steps to secure for its clients substantively equivalent outcomes*".

FCA's conclusion is that this will mean the investment firm should ensure that the delegate complies with standards which are very close to the letter of the MiFID II inducement rules (albeit not necessarily identical). In our view, there is room for different interpretations on this point, and that outcomes could be "substantively equivalent" with a looser alignment between the MiFID II regime and the conduct of the non-EU delegate. However, we note that FCA have established a clear view of their desired policy outcome and we do not comment on this.

We note, therefore, that it does not necessarily follow that a delegate should be required by contract to comply, in a similar way, with standards which seek closely to replicate the detailed requirements of other MiFID II provisions (such as best execution or transaction reporting) provided that the investment firm is satisfied that a substantively equivalent outcome is achieved for the client, when assessed in a proportionate way relative to the degree of delegation to the third country firm.

Consequently, the statement in your letter that FCA "*disagree with a narrow reading that the inducements provisions fall away*" should not be interpreted as meaning the inducement rule in fact continues to apply to the delegate. Indeed, it is clear from the rest of your letter that the rule does not apply, but rather, the delegating firm should ensure that substantively equivalent outcomes are achieved. This view is also supported by the FCA's recent comments in the context of sharing research within buy-side groups. It is both wrong, and unnecessary to support the conclusions in your letter, to assert that the MiFID II rules apply to the delegate.

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 sincerely

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)
Simon Crown (Clifford Chance LLP)
Richard Everett (Travers Smith LLP)
Robert Finney (Holman Fenwick Willan LLP)
William Garner (Charles Russell Speechlys 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)
Ben Kingsley (Slaughter and May)
Tamasin Little (Reed Smith LLP)
Brian McDonnell (Addleshaw Goddard LLP)
Simon Morris (CMS Cameron McKenna LLP)
Rob Moulton (Latham & Watkins LLP)
Richard Small (Stephenson Harwood LLP)
James Perry (Ashurst LLP)
Stuart Willey (White & Case LLP)