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

Via Electronic Submission

26 October 2016

Dear Sir or Madam,

Re: FCA Consultation Paper CP16/19, "Markets in Financial Instruments Directive II Implementation"

The Alternative Investment Management Association[1] ("AIMA") and Managed Funds Association ("MFA")[2] (collectively: "the Associations"; "we") welcome the opportunity to provide comments to the Financial Conduct Authority (the "FCA") on its second Consultation Paper relating to UK implementation of MiFID II (the "Consultation Paper"). The Associations have been actively engaged in commenting on the MiFID II drafting process from the outset, both at EU and UK level.

In general, the Associations agree with the "copy-out" approach that the FCA has taken in relation to incorporating the Level 1 and Level 2 text of MiFID II[3] into the FCA Handbook. We support in particular efforts by UK and other EU regulators to keep the drafting of national implementing measures as close to the text of MiFID II as possible, given that this approach should increase the probability of harmonisation across the European Union. Nevertheless, and whilst we understand

[1] AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,700 corporate members in over 50 countries. AIMA works closely with its members to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes, and sound practice guides. Providing an extensive global network for its members, AIMA's primary membership is drawn from the alternative investment industry whose managers pursue a wide range of sophisticated asset management strategies. AIMA's manager members collectively manage more than $1.5 trillion in assets.

[2] The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

[3] Directive 2014/65/EU on markets in financial instruments.

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that much of the "Level 3" guidance on MiFID II implementation is likely to come from the European Securities and Markets Authority ("ESMA"), there are certain issues surrounding UK implementation that we feel would benefit from further guidance by the FCA.

In particular, our members are concerned to ensure that adequate guidance on the application of position limits is in place in sufficient time to ensure a smooth implementation of the new regime. Such advance guidance will be vital to avoid volatility or a sudden reduction in market liquidity. For this reason, as well as in light of the UK's significant share of commodity derivatives trading in the EU, the FCA's approach to implementing the position limits regime in particular will be of critical importance to our members.

There are certain additional issues that are specific to UK implementation, and which have not been dealt with in either the MiFID II Level 1 or Level 2 text. One important example is the lack of data security measures that have been built into the MiFID II regime, particularly in relation to trading venues. Again, this is an issue where AIMA and MFA members would prefer to see FCA require in the FCA Handbook that trading venues have effective information security safeguards in place to reduce the likelihood of any data leaks.

With these points in mind, please see below our responses to certain of the questions posed by the Consultation.

Q2. Do you agree with our proposed new MAR chapter, MAR 10? If not, how would you suggest we modify our proposals?

In general, the Associations agree with the FCA's proposed draft of MAR 10. However, as noted above, there are certain issues surrounding implementation that we feel would benefit from additional FCA guidance.

We understand ESMA may not publish the final text of the Regulatory Technical Standards ("RTS") governing position limits for some time, given that there is an ongoing debate surrounding position limit methodology at EU level. Despite this delay, it is vital that market participants gain as much certainty regarding the scope and application of the position limits regime as possible ahead of time, and also as discussed below, that the FCA adopt adequate phase-in and grandfathering arrangements to avoid volatility at the outset of the new regime. With this in mind, we have set out below certain issues that the FCA could consider giving UK-specific guidance on.

<u>Application of the position limits regime to non-UK counterparties</u>

For the reasons outlined below, we respectfully ask the FCA to further clarify the application of the position limits regime with respect to non-UK counterparties. The Associations recommend that the FCA reviseo MAR 10 to state that only those "economically equivalent" contracts that have a link to the UK will be subject to position limits. In addition, it would be helpful for the FCA to provide examples of a "link" to the UK that could trigger the application of position limits set by the FCA.

This revision would substantially enhance legal certainty for counterparties established and

trading in third countries, and would reflect HM Treasury's statement at page 22 of its Consultation on the Transposition of the Markets in Financial Instruments Directive II[4] that:

> *in respect of the limits which the FCA will be required to set, the limits apply to any persons regardless where they are situated, provided there is a link to a contract traded on a UK market. This means that where two persons in a third country with no link to the UK trade economically equivalent OTC contracts the limits do not apply.*

The Associations agree with HM Treasury's approach in this respect, given that any attempt to apply position limits to "economically equivalent" OTC derivative contracts entered into by third country entities with no link whatsoever to the UK would be unworkable in terms of policing, supervising and enforcing in practice.

Although the FCA acknowledges HM Treasury's view on where the territorial scope of the position limits regime should be set in its Consultation Paper, this approach is not clearly reflected in the draft MAR text that the FCA has proposed. Instead, draft MAR 10.1 simply states that "in respect of position limit requirements in MAR 10.2, a commodity derivative position limit established by the FCA applies regardless of the location of the person at the time of entering into the position and the location of execution". Thus, although HM Treasury's implementing legislation is yet to be finalised, we strongly recommend that the MAR text be revised to reflect more clearly the territorial limitations of the UK position limits regime.

Aggregation

Draft MAR 10.2.2 D (3) states that "[p]osition limits established under (1) shall apply to the positions held by a *person* together with those held on its behalf at an aggregate group level". This closely parallels the drafting of Article 57(1) of MiFID II, which similarly refers to the positions held at an "aggregate group level".

The Associations believe that the FCA should clarify that in a fund management context, this implies aggregation of position at the level of fund/account, rather than at the level of the investment manager that provides discretionary portfolio management to the fund/account.

Our reading of the MiFID II primary legislation is that position limits should be understood as applying to the person who owns the position (the fund) rather than the person who controls it (the manager). This reflects the fact that the term group is defined in Article 4(34) of MiFID II by cross-reference to Article 2(11) of Directive 2013/34/EU (the Accounting Directive). In the context of the Accounting Directive, a group is "a parent undertaking and all its subsidiary undertakings", which does not describe the relationship between an investment manager and the fund or account that it manages.

We appreciate that the final approach in respect of aggregation will be shaped by implementing measures from the European Commission, and have suggested that the final regulatory technical standards in respect of position limits should develop the definition of "group" further by clarifying

[4] Available at: https://www.gov.uk/government/consultations/transposition-of-the-markets-in-financial-instruments-directive-ii

that positions held by a fund are not to be aggregated at either manager level or by the investor in a fund. This would ensure a clear and consistent approach to the primary legislation across Europe.

To the extent that there is any ambiguity in the final implementing measures, we would suggest that the FCA work with ESMA to develop Level 3 guidance in the form of Questions and Answers on this topic in order to clarify the application of the position limits framework.

The need for appropriate phase-in/grandfathering

Although MAR 10 does not specifically deal with phase-in of position limits or grandfathering, this will be a vital issue surrounding implementation of the position limits regime in the UK. The Associations' members would therefore like the FCA to adopt a notice period of at least six months applying to position limits before they take effect, to allow adequate lead in time for implementation. We also consider that grandfathering of existing positions is vital, in order to avoid a large-scale sell-off of commodity derivative positions prior to the application of the new regime.

Position reporting

Timing of report submission

We note that MiFID II requires UK investment firms trading in commodity derivatives outside a trading venue to provide the FCA with a daily breakdown of the firms' positions in any commodity derivatives which the firms traded on a trading venue and in economically equivalent OTC contracts. We agree with the FCA's decision to require these reports to be submitted by GMT 17:00 on the business day following the day to which the report relates, given that this should allow sufficient time for investment firms that have a reporting obligation to collate and check the reportable data, building in time for coordinating with teams in overseas offices on different time zones if necessary. We would recommend that the same standard (i.e. GMT 17:00 on the day following execution) be explicitly extended in MAR to the parallel position reporting regime applying to members and participants of trading venues under Article 58(3) of MiFID II.

Need for delegated reporting

The Associations urge the FCA to introduce an explicit mechanism for delegated reporting of position data (i.e. delegated either to the trading venue or to a counterparty where applicable). The ability to delegate reporting of transaction data under the EMIR regime has proven extremely helpful in practice, and has helped to reduce the pressure on market participants' back office functions. The FCA should bear in mind the broad scope of position reporting under MiFID II in this respect – many entities that may already have stretched resources and little previous experience of reporting market data would benefit from delegated reporting. Given that positions are to be reported on a gross rather than a net basis, delegation to counterparties etc. should not pose a problem in practice.

Data security and confidentiality issues

Importance of confidentiality safeguards

In light of the substantial amount of data that will be passing through trading venues under MiFID II, the Associations consider it vital that the FCA amend the FCA Handbook to require trading venues to have specific confidentiality safeguards relating to position reporting. Clearly, any data leaks of a market participant's positions could prove enormously damaging in revealing that market participant's trading strategies and risk exposure to the market.

We note in this regard that the new position limits and position management regimes will grant significant new information gathering powers to trading venues. For example, the MAR standards proposed in the Consultation Paper will grant trading venues wide-ranging position management powers, including the ability to access information about the size and purpose of positions and any beneficial or underlying owners. These powers have not been accompanied by higher standards on data security (at present, for example, the FCA Handbook does not impose detailed data security requirements on trading venues). Trading venues will also receive a substantial amount of data on market participants' positions under the position reporting regime set out in Article 58 of MiFID II. Whilst trading venues may already have certain position management powers in place, this is the first time that their power to access such information will be underpinned by the UK regulatory regime. We therefore consider that the FCA should adopt a corresponding regulatory obligation on trading venues requiring them to have effective information security, including cyber security safeguards to reduce the likelihood of any data leaks.

Reporting of end clients' positions

Another area of implementation to which the FCA could give further thought is its approach to implementing the requirement set out at Article 58(3) of MiFID II for market participants to report not only their positions, but the positions of their client, their client's client, and so on until the end client is reached. In light of confidentiality concerns about data on clients' positions being passed through chains of intermediaries on one hand, and the ability of investment firms to gain access to the necessary data on the other, the FCA should give thought to a regulatory-backed mechanism, in order to allow the appropriate data to be reported without undermining the confidentiality of client positions. We consider that this would provide greater certainty and additional protection to the alternative of a market-led solution.

One possibility that the FCA could consider (which was originally proposed by ESMA, prior to ESMA's conclusion that it did not have a mandate to determine the point) would be to allow for internal identifiers for clients to be passed through chains of intermediaries. Such internal identifiers could be constructed by whichever investment firm ultimately holds the end-client's account, and would have the advantage of ensuring that the end-client's identity is not disclosed to any intermediary involved in the transaction chain. The investment firm that constructed the code could then be required to disclose the end client's identity directly to the FCA.

Position management powers: scope issues

The text of MAR 10 states that trading venues may "require a person to provide liquidity back into the market at an agreed price and volume on a temporary basis with the express intent of mitigating the effects of a large and dominant position". The FCA has not, however, given any guidance on when trading venues may use this power, or on what a "large and dominant position" could be. Such guidance would be helpful in ensuring that trading venues do not misuse this power, and that its scope is limited to well-defined scenarios. The Associations believe that trading venues should only invoke this authority under extreme circumstances.

Q9: Do you agree with our proposals on the application of the requirements in Articles 21 to 25, 30 to 32, and 72 of the MiFID Org. Regulation to the non-MiFID business of common platform firms, Article 3 MiFID firms and third-country firms? If not, please give reasons why.

We note the discussion at section 5.3 of the CP in respect of the application of MiFID II requirements to UCITS managers and alternative investment fund managers' MiFID business. Draft SYSC 1 Annex 1 Part 2.6C R states that "[T]he *common platform requirements* apply to an *AIFM investment firm* which is a *full-scope UK AIFM* in respect of its *MiFID business* in line with Column A in Table A of Part 3". For the sake of clarity, we believe it would be helpful to amend the wording of Table A to reinforce the point that the requirements detailed in Column A are only applicable in respect of the relevant common platform firm's MiFID business and do not extend to its non-MiFID business.

Q11: Do you agree with our proposed approach to implementing the MiFID II requirements on conflicts of interest? If not, how could we amend it?

As with the position limits regime, while we broadly agree with the FCA's proposed approach to implementing the MiFID II requirements, additional guidance on the scope of the conflicts of interest regime would be helpful.

For example, MiFID II enhances the standard governing the steps that firms must take to prevent and manage conflicts of interest from "reasonable" to "appropriate". Although the Consultation Paper notes that this "sets a somewhat higher bar, but still places the onus on firms to ensure compliance", additional guidance on the new conflicts of interest standard would be helpful. For example, one important matter that has yet to be clarified is the circumstances in which firms will in future be able to manage conflicts of interest simply by disclosing them (which MiFID II makes clear is to be a last resort).

In addition, we note that the Consultation Paper indicates that certain conflicts of interest requirements should apply as "guidance" to AIFMs and UCITS management companies, regardless of whether they are undertaking MiFID business or not. Given this proposed extension in scope, the FCA should make clear exactly how such firms can demonstrate that they are meeting the required standard.

Q13: Do you agree with our proposals on the transposition of Article 9 (on the management body)? If not, please give reasons why.

In general, the Associations agree with the FCA's proposed transposition of Article 9, which appears to take a "copy-out" approach to the legislation. Many of the requirements envisaged by Article 9 would already be seen as "good practice" by our members. However, the FCA should bear in mind that whereas in the past these requirements would apply to more sophisticated firms subject to the CRD IV regime, under MiFID II, they will be extended to smaller firms that might not have the same personnel resources. For example, in certain firms it might be more difficult to distinguish between the role of the management body and of "senior management" (which the management body is required to oversee under MiFID II). For this reason, smaller firms should be permitted to take a proportionate approach to demonstrating that they comply with the terms of Article 9.

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The Associations would be pleased to discuss the issues addressed in this letter with you. Please do not hesitate to contact Jennifer Han (JHan@managedfunds.org) or Adam Jacobs-Dean (ajacobs-dean@aima.org) in relation to the issues raised in this letter.

Respectfully submitted,

/s/ Stuart J. Kaswell Stuart J. Kaswell Executive Vice President & Managing Director, General Counsel MFA	/s/ Jiří Król Jiří Król Global Head of Government Affairs AIMA