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

By email: cp15-43@fca.org.uk

8 March 2016

Dear Sirs,

CP15/43: Markets in Financial Instruments Directive II Implementation - Consultation Paper I – AIMA/MFA response

The Alternative Investment Management Association (**AIMA**)[1] and Managed Funds Association[2] (**MFA**; collectively, "we") welcome the opportunity to respond to the Financial Conduct Authority (**FCA**) regarding "CP14/43: Markets in Financial Instruments Directive II Implementation - Consultation Paper I" (**the CP**).[3]

In the context of MiFID II transposition, our strong preference is for an approach based on copy-out of the MiFID II text without substantial modifications. We believe that this approach will make for greater consistency across Europe and will limit the potential for unnecessary "gold-plating" of MiFID II standards. We therefore welcome the approach that the FCA is planning to pursue in a number of areas and express our broad support for the proposed handbook language. We appreciate in particular the FCA's open and collaborative approach to MiFID II implementation thus far, and its efforts to keep the market updated on developments at EU and national level.

We do, however, wish to take this opportunity to highlight some of the practical implications of the new MiFID II framework, particularly to the extent that they might warrant further elaboration from the FCA (or, in some cases, the European Securities and Markets Authority (**ESMA**)) to provide further clarity to market participants or to ensure that rules are being applied correctly. In the Annex to this letter we address a number of points:

- We believe that regulatory guidance will play an important role in providing legal certainty and helping market participants to understand and properly comply with the new rules. We agree with the FCA's comment at paragraph 11.20 of the CP that the developments contemplated by MiFID II do not diminish the need for national guidance on scope issues, particularly given the potential criminal and civil consequences of acting in breach of the

[1] Founded in 1990, the Alternative Investment Management Association (AIMA) has over 1,700 corporate members and over 10,000 individual contacts in over 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. 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] *See* http://www.fca.org.uk/static/documents/consultation-papers/cp15-43.pdf.

general prohibition. However, in the interests of promoting cross-border harmonisation, an open process for raising questions at ESMA level will be vital, and we appreciate the role of national regulators such as the FCA in supporting this EU-level guidance process. We would particularly welcome further guidance on the application of MiFID II to investment managers, including those that are not MiFID investment firms.

- It is important for the FCA to implement the MiFID II requirement on non-discriminatory access to Organised Trading Facilities (**OTFs**) and Multilateral Trading Facilities (**MTFs**) in such a way that eliminates current barriers to access. These barriers restrict the ability of investors to execute freely with any other counterparty, limit investors' choice of trading protocols, compromise investors' ability to trade at the most favorable prices, inhibit new liquidity providers from entering the market, and engender concentration of risk in the dealer community. As national competent authority for UK trading venues, the FCA will be on the "front line" for assessing whether the requirement in a MiFID II for non-discriminatory access has been met by existing and prospective venues, or whether the existing paradigm, which includes barriers to access, is preserved.

- Pre- and post-trade transparency requirements should be calibrated and transposed in a manner that advances the MiFID II goal of furthering market transparency whilst maintaining liquidity. We express our support for the FCA's proposals to make transparency waivers and deferrals available in appropriate cases, such as for less liquid fixed income products. However, it is vital to distinguish appropriately between different categories of non-equity instruments in calibrating transparency requirements.

- Regulatory reporting is a major compliance burden for our members. We therefore welcome the FCA's statement that it will not read-across MiFID II transaction reporting requirements to Alternative Investment Fund Managers (**AIFMs**) or managers of Undertakings for Collective Investment in Transferable Securities (**UCITS**). We continue, however, to see the need for a comprehensive debate at European level about the possibility of moving towards single-sided reporting structures to avoid any undue burdens on buy-side market participants.

- Given recent evidence of a tendency towards increasingly detrimental and recurrent large-scale attacks conducted against information systems, it is critical that systems which will be used to receive and store reported transaction data are kept secure. As authorities require market participants to make increasing amounts of data available under regulatory reporting regimes, additional regulatory safeguards should be put in place to ensure that the information to be reported remains secure and that effective controls are put in place to guard against cyber attacks.

We would be happy to discuss any of these points with you further.

Yours faithfully,

[s]

Jiří Król
Deputy CEO
Global Head of Government Affairs
The Alternative Investment Management Association Limited

[s]

Stuart J. Kaswell
Executive Vice President & Managing Director, General Counsel
Managed Funds Association

Annex 1

Q1: Do you find our proposed MiFID II Guide helpful? If not, how can we amend and improve the prototype?

We believe that the MiFID Guide included in Appendix 2 of the CP is a useful template for future work by the FCA and would encourage the FCA to continue to develop material of this nature for other MiFID II/MiFIR requirements. Indeed, we would encourage the FCA to consider working with ESMA on incorporating such an approach into any relevant Level 3 guidance published by ESMA.

From the point of view of our respective members, guidance on the scope of MiFID II/MiFIR in an investment management context would be particularly welcome, reflecting the fact that there will be differences in the nature of requirements that apply to:

- investment managers that are MiFID investment firms;
- investment managers that are authorized or registered as Alternative Investment Fund Managers (AIFMs) under Directive 2011/61/EU;
- investment managers that are not authorized under EU regulation but that access EU markets via direct electronic access (DEA).

Asset management firms may include entities across this range of options, further adding to the challenge of assessing the scope of new requirements and implementing the rules correctly. Scope guidance focusing on asset management would provide a valuable foundation for global asset managers to implement MiFID II.

We also note that the position in respect of investment managers that are not authorized under EU regulation is potentially more challenging from an interpretative standpoint, given that third-country entities will need to take into account both the obligations that apply to DEA providers (and, indirectly, their clients), as well as the changes to the MiFID Article 2 exemptions, which could both have a bearing on the aspects of MiFID II that will be relevant for them. We understand that ESMA has encouraged the European Commission to opine on the application of the existing MiFID framework to third-country firms that access European markets via DEA, something that would be welcome. In our view, third-country firms accessing EU trading venues via DEA arrangements should not be subject to the MiFID authorisation framework, particularly in view of issues surrounding supervision and enforcement.

Q4: Do you agree with our approach to implementing the MTF requirements in MAR 5? If not, please give reasons why

We generally support the FCA's proposed implementation of MTF rules in MAR 5 and encourage the FCA to focus in particular on the implementation of non-discriminatory access provisions.

By way of background, Article 18(3) of MiFID II requires that an investment firm or market operator operating an MTF or an OTF establish, publish and maintain and implement transparent and non-discriminatory rules, based on objective criteria, governing access to its facility.

We view this requirement as crucial to enhancing competition in secondary markets and addressing the two-tier market structure that has historically characterised trading of derivatives and bonds.

Under the existing paradigm, a small group of dealers are able to transact with each other on exclusive "dealer-only" trading platforms, commonly referred as the "inter-dealer" or "D2D" market. These platforms deny access to all other types of market participants, including investors (e.g., investment funds, insurance companies, corporations, etc.).

For investors, the only way to transact with that group of dealers is either bilaterally or on a limited number of "dealer-to-customer" or "D2C" trading platforms. This market structure is suboptimal in a number of respects, as it restricts the ability of investors to execute freely with any other counterparty, limits investors' choice of trading protocols, compromises investors' ability to trade at the most favorable prices, inhibits new liquidity providers from entering the market, and engenders concentration of risk in the dealer community.

Accordingly, we encourage the FCA to ensure that proposed MAR 5.3.1R(4) is treated as a supervisory priority under the new MiFID II framework. Specifically, it is important that non-discriminatory access requirements are applied across all trading venues to ensure that the largest incumbent dealers are not in a position to push venues to maintain historical market structures that advantage the dealer community at the expense of investors. As such, the FCA should scrutinize trading venues to ensure that they are fully compliant with the non-discriminatory access requirement set out in MAR 5.3.1R(4).

Q5: Do you agree with our proposals on how to implement OTF rules in MAR 5A? If not, please give reasons why

We generally support the FCA's proposed implementation of OTF rules in MAR 5A and encourage the FCA to focus in particular on the implementation of non-discriminatory access provisions.

As detailed in our response to the previous question, Article 18(3) of MiFID II requires that an investment firm or market operator operating an MTF or an OTF establish, publish and maintain and implement transparent and non-discriminatory rules, based on objective criteria, governing access to its facility.

We view this requirement as crucial to enhancing competition in secondary markets and addressing the two-tier market structure that has historically characterised electronic trading of derivatives and bonds.

Under the existing paradigm, a small group of dealers are able to transact with each other on exclusive "dealer-only" trading platforms, commonly referred as the "inter-dealer" or "D2D" market. These platforms deny access to all other types of market participants, including investors (e.g., investment funds, insurance companies, corporations, etc.).

For investors, the only way to transact with that group of dealers is either bilaterally or on a limited number of "dealer-to-customer" or "D2C" trading platforms. This market structure is suboptimal in a number of respects, as it restricts the ability of investors to execute freely with any other counterparty, limits investors' choice of trading protocols, compromises investors' ability to trade at the most favorable prices, inhibits new liquidity providers from entering the market, and engenders concentration of risk in the dealer community.

Accordingly, we encourage the FCA to ensure that proposed MAR 5A.4.1R(6) is treated as a supervisory priority under the new MiFID II framework. Specifically, it is important that non-discriminatory access requirements are applied across all trading venues to ensure that the largest incumbent dealers are not in a position to push venues to maintain historical market structures that advantage the dealer community at the expense of investors.

Q6: Do you agree with our approach to implementing the SI regime in MAR 6? If not, please give reasons why

While we do not have detailed comments on the FCA's approach to implementing rules for systematic internalisers (**SIs**), we take this opportunity to highlight the fact that asset managers will face significant challenges under the new regime in gaining a comprehensive view of the regulatory status of their trading counterparties, and in particular the extent to which they act as SIs for particular financial instruments. One specific concern is our understanding that the required data on EU-wide turnover, total nominal amount, and total number of transactions in specific financial instruments may not be published until the date of MiFID II's entry into force, making it very difficult for market participants to assess in advance whether they could be caught by the SI category.

This will make planning for implementation difficult not only for proprietary traders that could be caught within the scope of the SI regime, but also for asset managers seeking to assess the nature of transparency requirements that will apply to activity with a particular broker.[4] Although we recognize that the publication of transaction data required under the SI regime is ultimately an EU-level initiative, national competent authorities may well need to contribute to the data collection process, and we encourage the FCA to help ensure that this data collection process is commenced in a timely fashion. It may also be worthwhile for the FCA to undertake further work to consider the manner in which investment firms communicate their regulatory status to their clients, to ensure that clients fully understand the regulatory implications of trading with a particular counterparty.

Q7: Do you agree that we should be prepared to use our power to grant waivers from pre-trade transparency in shares, ETFs, and depositary receipts in relation to:

- **systems matching orders on the basis of a reference price**
- **systems that formalise negotiated transactions**
- **orders that are large in scale, and**
- **orders held in an order management facility pending disclosure?**

If not, please give reasons why

Recital 16 of MiFIR stipulates that transparency requirements "should be calibrated for different types of trading, including order-book and quote-driven systems such as request for quote as well as hybrid and voice broking systems, and take account of transaction size, including turnover, and other relevant criteria".

We fully agree with the FCA's assessment, as expressed in para 6.9 of the CP, that waivers from MiFIR transparency requirements are important to ensure an appropriate balance between transparency and liquidity in equities markets, and therefore support the FCA's intended approach of maintaining these waivers in its transposition of the MiFID II framework.

Q8: Do you agree that we should use our power to grant waivers from pre-trade transparency in bonds, structured finance products, derivatives and emission allowances in relation to:

- **orders that are large in scale**
- **orders held in an order management facility pending disclosure**
- **actionable indications of interest in request-for-quote and voice trading systems, and**
- **derivatives that are not subject to the trading obligation under article 28 of MiFIR, and other financial instruments for which there is not a liquid market?**

If not, please give reasons why

As described in our response to Question 7, Recital 16 of MiFIR stipulates that transparency requirements "should be calibrated for different types of trading, including order-book and quote-

[4] This relates both to pre-trade transparency, where trading with an SI could entail a client's quote being shared more broadly with the SI's client base, and post-trade transparency, where trading with an SI could entail relying on the SI to satisfy the MiFIR Article 21 post-trade transparency requirement, on the basis of Article 7 of draft RTS 2 which makes an SI responsible for post-trade reporting of a transaction with a non-SI investment firm.

driven systems such as request for quote as well as hybrid and voice broking systems, and take account of transaction size, including turnover, and other relevant criteria".

We fully agree with the FCA's assessment, as expressed in para 6.15 of the CP, that transparency requirements for non-equity markets should be calibrated in a way that reflects the lower and episodic liquidity of many non-equity instruments. This consideration is particularly important at the present time, given that many fixed income instruments, notably corporate bonds, have experienced a drop in liquidity in recent months.[5]

We therefore support the approach that the FCA puts forward in the CP. As a general comment, however, we are unsure of how transparency requirements will apply in a voice-traded environment. We encourage the FCA to work together with trading venues that apply for authorisation under MiFID II (or which update existing authorisations) to ensure that such transparency requirements can be satisfied in a commercially and operationally viable way.

We would also like to take this opportunity to highlight our view that the MiFIR primary legislation should itself be reworked to ensure that the transparency framework is designed in a way which accommodates package transactions. We note that this view has been expressed by ESMA in its "Final Report - Draft Regulatory and Implementing Technical Standards MiFID II/MiFIR"[6] (28 September 2015), in which it recommends "an amendment of MiFIR, which would allow for a tailored treatment of packages also in the context of pre-trade transparency". We note in particular that such tailored treatment should account for different types of package transactions. Some package transactions, such as interest rate curves and butterflies containing cleared OTC derivatives, are highly liquid and therefore it would be sensible to apply transparency obligations to them. On the other hand, some package transactions are illiquid and therefore should benefit from an exemption. We encourage the FCA to continue to support ESMA's efforts to achieve an appropriate amendment for package transactions ahead of the application date of the MiFID II framework.

We further believe that the impact of transparency requirements can be lessened by phasing them in over an appropriate period of time.

Q11: Do you agree that we should be prepared to authorise operators of trading venues and investment firms to defer the publication of post-trade information in relation to large in scale transactions in shares, ETFs, and depositary receipts executed by investment firms acting in a principal capacity? If yes, should we provide guidance in the Handbook on the process for applying for deferrals? If not, please give reasons why

We support the FCA's suggested approach which would authorize the deferred publication of details of transactions in shares, ETFs and depository receipts for transactions that are large-in-scale.

---

[5] Bank for International Settlements: "Shifting tides - market liquidity and market-making in fixed income instruments" by Ingo Fender and Ulf Lewrick, 18 March 2015. See http://www.bis.org/publ/qtrpdf/r_qt1503i.htm.
6 *See* https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1464_-_final_report_-_draft_rts_and_its_on_mifid_ii_and_mifir.pdf.

Q12: Do you agree that we should authorise operators of trading venues and investment firms to provide for deferred publication in relation to transactions that are:

- **large in scale**
- **in financial instruments for which there is not a liquid market**
- **above the size specific to the instrument, and**
- **packages If yes, do you agree that we should set up the process for the use of guidance in the Handbook for the application of deferrals?**

If not, please give reasons why

While we generally support the FCA's suggested approach which would authorize the deferred publication of details of non-equity transactions where the conditions for deferral are met, we await finalization of European-level work to determine situations in which deferral would apply. In this context, we share the concerns of other industry participants that transparency requirements should not be applied in a manner that could undermine market liquidity, particularly for infrequently traded or illiquid fixed income instruments, including corporate bonds. At the same time, however, we would highlight that there is a broad spectrum of non-equity instruments that fall within the MiFID II transparency framework, including instruments that can and should be subject to real-time post-trade transparency in order to support price formation and achieve suitable alignment with the rules of other jurisdictions.[7]

Indeed, even when transparency requirements have been set, there will be a need for the FCA to monitor on a regular and ongoing basis the application of post-trade transparency deferrals to ensure that the MiFID II transparency and competition objectives are being met.

Q13: Should we:

- **use our powers under article 11(3) of MiFIR further to calibrate post-trade deferrals in accordance with the above options**
- **require additional information to be made public during the deferral period? and/or, should we:**
- **permit the omission of the volume, or the aggregation of information, for an extended time period of four weeks?**

If not, please give reasons why

While we believe that the FCA should permit the omission of the publication of the volume of individual transactions for a period of four weeks after the day of the trade, we do not believe that this will be appropriate in practice for all transactions that fall under a post-trade transparency waiver. For example, a four week deferral might be appropriate for a highly illiquid corporate bond, but inappropriate for a large-in-scale transaction in a highly liquid interest rate derivative. It would therefore be helpful to understand further whether the extended deferral would be applied as a default or whether it would be applied to specific groups of contracts on the basis of their particular liquidity characteristics.

[7] For example, under the US regime, block trades in OTC derivatives that are subject to the clearing obligation are reported same day with only a 15 minute delay and with notional amounts capped at the block threshold.

Q15: Do you agree with our proposal not to apply the transaction reporting obligation to managers of collective investment undertakings and pension funds? If not, please give reasons why

We strongly agree with the FCA's suggested approach that it will not apply the transaction reporting obligation of Article 26 of MiFIR to managers of collective investment undertakings and pension funds. As the FCA rightly notes in the CP, a non-MiFID investment manager is likely to be facing a MiFID investment firm which will continue to provide transaction reports to the FCA, thereby providing the information that FCA needs to monitor market abuse. The FCA will also receive information on firms' activities through transaction reports provided by trading venues on behalf of non-MiFID investment firms, and also order data from trading venues.

We believe that this approach will make a meaningful contribution to ensuring effective compliance while minimizing the compliance costs that arise from MiFID II implementation. Indeed, it is possible that if the FCA were to expand the scope of MiFID II transaction reporting to cover managers of collective investment schemes not authorised under MiFID, double-reporting could result. Specifically, the obligation set out in Article 26(5) of MiFIR requires trading venue operators to file transaction reports on behalf of any "firm which is not subject to this Regulation in accordance with paragraphs 1 and 3". Given that paragraph 1 of Article 26 refers specifically to authorised investment firms, it is unclear that a national extension of the MiFID II reporting obligation to entities that do not qualify as authorised investment firms would relieve trading venue operators of their reporting obligation under Article 26(5).

Given that many asset management firms do, however, include MiFID authorized investment firms that are directly subject to transaction reporting, the scope and mechanics of transaction reporting are of significant interest to our members. In particular, there is a broad concern that the concept of "transmission of an order" as described in draft RTS 22 Article 4 could prove difficult to implement in practice, given that there may be commercial disincentives for brokers to agree that they will report transactions resulting from transmitted orders, just as asset managers might be reluctant to provide commercially sensitive information to their counterparts for the purposes of transaction reporting. Many asset managers that are MiFID investment firms have therefore concluded that they are likely to have to submit their own transaction reports, creating significant additional compliance costs for buy-side firms.

We also believe that the European Commission's Capital Markets Union (**CMU**) project provides a good opportunity to consider reporting requirements more broadly. A key question is whether dual-sided reporting remains an appropriate model and whether it would instead make sense to move towards single-sided reporting under EMIR, MiFID II and the SFTR. There is also a strong case to consider how reporting fields can be streamlined across legislative texts, and we welcome ESMA's current work under the Market Data Standing Committee to consider how to standardize reporting requirements with a view to reducing the operational burden on firms that arises from regulatory reporting.

Finally, we wish to draw the FCA's attention to the importance of data security in this context. It is clear that the market as a whole sees data security as a top priority for regulators; for example, the Bank of England's 2015 Systemic Risk Survey Results indicate that the UK financial industry sees online attacks as a top risk, outweighing sovereign defaults and market disruptions[8]. In our view, it is critical that systems which will be used to receive and store reported transaction data are kept secure. Clearly, this is a concern in relation to data held directly by the FCA (and potentially by others on the FCA's behalf), along with reporting infrastructure such as Approved Reporting Mechanisms.

---

[8] For example, 46% percent of respondents to the Survey cited the threat of cyberattacks as one of the three greatest threats to their operations – see http://www.bankofengland.co.uk/publications/Documents/other/srs/srs2015h2.pdf

In addition, the MiFID II regime will require significant amounts of data to be reported directly to trading venues (e.g. under the commodity derivatives position reporting regime). This data will, for example, identify not only market participants' positions, but also "those of their clients, the clients of those clients and so on until the end client is reached", and so will contain highly confidential data on the identity of the end client to the transaction. We would therefore like to see a specific confidentiality safeguard introduced into the FCA Handbook in relation to trading venues, given that they will be collecting significant amounts of confidential data under MiFID II. Despite the fact that trading venues are currently subject to a general conduct framework in the UK, there are no adequate regulatory safeguards surrounding data security. Clearly, any data leaks of a market participant's positions (or those of its end client) could be enormously damaging in revealing that entity's proprietary trading strategies (which may be critical to providing an attractive return to investors) and risk exposure to the market.

Q17: Do you agree with our proposal to add in the rules outlined above to our Handbook? If not, please give reasons why

In general, we agree with the FCA's "copy-out" approach in this respect. However, we note that there are certain areas where additional UK-specific regulation could be helpful in relation to the new requirements surrounding algorithmic trading. For example, MiFID II will mean greater use of trading venues' testing environments and drop copy facilities, but does not entail significant additional regulation of these facilities. The FCA could consider, for example, regulating drop copy feeds to ensure that they are provided in real time and include at least a minimum amount of data relating to order and execution information. Improving the content and availability of drop copy feeds in real-time would enhance the ability of client firms to review and monitor their own trading algorithms in real-time and to quickly identify software malfunctions or other issues. It will also be vital to ensure that trading venues' testing environments meet the standards necessary for market participants to fulfill the algorithmic testing requirements envisaged by MiFID II.

Q18: Do you agree with our proposal to add a new section to MAR for Algorithmic and HFT firms, DEA providers and general clearing members? If not, please give reasons why

We believe that the FCA's preferred approach of creating a new, dedicated section of the Handbook for algorithmic trading requirements is preferable to the alternative option of incorporating the relevant standards into SYSC. This will provide greater clarity as to the firms that are subject to the algorithmic trading requirements, whilst making it easier to gain a consolidated view of those requirements.

Q19: Do you foresee any implementation issues with the content of MAR 7A? If so, please provide examples

As we note in our response to question 1, we believe that there is uncertainty in the market as to the implications of MiFID II for non-EEA firms, particularly when it comes to DEA provisions.

MiFID II Article 18(5) states that "an investment firm that provides direct electronic access to a trading venue shall be responsible for ensuring that clients using that service comply with the requirements of this Directive and the rules of the trading venue".

It is not clear that the FCA has directly copied this requirement into proposed MAR 7A. However, we believe that it is worth highlighting as it has the potential to create uncertainty as to how broadly MiFID II standards apply to DEA users, particularly if they are non-EEA firms that would not otherwise be subject to MiFID II obligations.

There are other practical aspects of MAR 7A that are likely to create a need for further guidance. For example, there is nothing in MiFID II or proposed MAR 7A.3.4R to define what would happen in a situation where a firm wished to cease its participation in a market marking strategy. While this could be addressed under the terms of the agreement between the venue and firm operating the market making strategy, it might be appropriate for ESMA to provide guidance on this point to ensure that trading venues do not adopt radically different approaches or put in place unreasonable terms.

Q20: Are you in favour of the reports under MAR 7A.3.7 and MAR 7A.4.5 being submitted to us regularly as opposed to an ad hoc basis?

We strongly support the FCA's proposal that persons engaging in algorithmic trading should report information to the FCA on an *ad hoc* basis, rather than a periodic basis. This would allow the FCA to request information at a point in time that makes greatest sense from the point of its ongoing supervision of firms that engage in algorithmic trading, whilst also reducing the burden on firms to provide information to the FCA.

We note that proposed MAR 7A.3.7 stipulates that a firm must respond to a request from the FCA for this information with 14 days from the receipt of the request. We believe that this time limit is potentially too restrictive, particularly where a firm is engaging in multiple algorithmic trading strategies covering multiple instruments. It is also shorter than other response deadlines that already exist under SUP 16.12.7, which range from 15 business days to 45 business days. We would therefore suggest that MAR 7A.3.7 be redrafted as follows

> "A *firm* must provide the following, at the *FCA's* request, within ~~14~~ **20 business** days from receipt of the request."

Q21: If you are in favour, what will be the advantages of regular reporting as opposed to ad hoc reporting?

We do not believe that requiring regular reporting would bring supervisory benefits, and would instead lead to the risk that the FCA will receive more information than it would be able to process effectively.

Q26: Do you agree with our proposal to update PRIN 1 Annex 1 to delete the possibility of local authorities being treated as ECPs for the purposes of PRIN in respect of non-designated investment business? If not, please give reasons why

Whilst we do not have a strong view regarding the possibility of local authorities being treated as ECPs for the purposes of PRIN, we would like to take this opportunity to highlight our concerns regarding the classification of local authorities under MiFID II.

Although "pension funds and management companies of such funds" remain categorised as professional clients under MiFID II, municipalities and local public authorities will in the future be treated as retail clients (albeit that they may "opt up" to professional client status). Due to the specific structure of local authority pension funds and the way in which assets are held in the UK, UK local authority pension funds are likely to be treated as retail rather than professional clients (such pension funds are held by local authorities as a ringfenced amount within the local authority's accounts, rather than as a fund separate from the local authority itself; we understand that this structure is driven by UK statutory requirements).

Given the relative sophistication of these funds and the size of their assets under management, it appears to us to be incongruous to treat them as retail clients. In addition, unless the relevant funds elect up to professional client status, they will find themselves faced with a considerably reduced pool of asset managers willing to provide them with services, and a significantly restricted range of products available to achieve their investment objectives.

Electing up to professional status is of course possible, but will require local authority pension funds to demonstrate to each asset manager they use that they meet the various qualitative and quantitative criteria set out under the MiFID regime. This process could be time-consuming where a number of asset managers are involved, and introduces a level of cost and complexity that appears to us to be unwarranted. In addition, we note that elective professional clients are required to keep firms informed in relation to any change which could affect their status as an elective professional. This introduces an ongoing compliance obligation, and where such changes are reported, the assessment process may need to be repeated. We also note that if the UK Government were to allow local authority pension funds to appoint non-EEA investment managers under the Local Government Pension Scheme Regulations, their status as retail clients may become problematic under MiFID II (which only extends the third country "registration" scheme set out in Article 46 of MiFIR to "per se" professional clients and eligible counterparties).

We therefore ask the FCA to consider whether it is able to distinguish between local authorities and their pension schemes in implementing MiFID II client categorisation rules, with pension schemes being treated as *per se* professionals.

To the extent that the FCA concludes that this is not possible, then the opt-up process is likely to be critical and we would argue that requirements to assess skills and competence should be applied in a manner that is workable and proportionate in light of the structure of Local Government Pension Schemes.

Q28: Do you agree with our interpretation of the definition of a multilateral system? If not, please give reasons why

Whilst we broadly agree with the FCA's approach to defining a multilateral system, we believe that it is important to clarify that Article 4(19) of MiFID II excludes internal crossing processes of asset managers. MiFID II Article 4(19) refers to:

> *"…any system of facility in which multiple third-party buying and selling trading interests in financial instruments are able to interact in the system."*

Internal crossing by our members does not allow multiple third-party interests to interact. Where crossing occurs, this is at the instigation of the manager rather than the client, e.g. rebalancing a portfolio. Where orders are crossed, this is carried out at the discretion of the manager, rather than through strict adherence to a set of pre-defined rules. There is no waterfall of interactions where buy interests meet sell interests.

In addition, such transactions do not contribute to the price formation process as the buy and sell interests are exactly matched and a reference price at mid is used. As distinct from transactions that occur on a multilateral systems such as MTFs, no brokerage commission, fee or other remuneration is paid by either client to the manager.

In carrying out any cross, the manager meets its fiduciary duty of care and its best execution obligations to both clients. Any conflicts are managed such that both clients are treated equally and fairly.

Internal crossing by an asset manager is distinct from the operations of multilateral trading systems and should not be characterised as such.