Consultation response

AFME response to FCA Consultation Paper 18/28
Brexit: proposed changes to the Handbook and Binding Technical Standards – first consultation

7 December 2018

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to respond to the FCA's Consultation Paper: Brexit: proposed changes to the Handbook and Binding Technical Standards – first consultation.

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.

Foreword

As a general point, our answers assume that UK firms will have the necessary licences to operate in the EU 27 and will be able to serve their EU clients.

Other issues may arise in FCA CP 18/36 that might affect our views on the questions in this consultation (CP 18/28).

Responses to specific questions

1. ***Do you think any of the proposed changes in this CP or in relevant SIs represent a significant risk to compliance for your firm in time for exit day? If yes, please specify which and explain why this is the case, including projected time needed to comply with requirements were they to come into effect on exit day.***

Paragraph 1.7 of the CP states that:

"As set out in our statement of 27 June 2018, and following the announcement on 8 October, the Treasury has communicated that it will bring forward measures that will give the regulators some flexibility to phase in changes to firms' regulatory requirements under the EUWA. We are willing to use these powers to waive or modify some requirements to allow for a smooth transition to the post-exit regulatory regime. This means we do not expect firms, regulated entities providing services within the UK's regulatory remit and other stakeholders to prepare now to implement the changes from exit day. At the same time, we would be interested in views from stakeholders regarding any aspects of the proposed changes to firms' regulatory requirements which might cause implementation challenges if the changes were to come into effect on exit day. We address this in Chapter 2."

The Treasury announcement on 8 October (Guidance on a proposal for a temporary transitional power to be exercised by UK regulators) states that:

"HM Treasury and the UK regulators set out in June that they do not expect firms providing services within the UK's regulatory remit to have to prepare now to implement these changes from 29 March 2019. HM Treasury will ensure that the UK's regulatory regime is flexible enough to support firms as they adjust to altered regulatory requirements in the unlikely event that there is no implementation period."

AFME understands the FCA will not be able to confirm which changes are required for exit day until HM Government formally announces that the industry should actively prepare for a no-deal Brexit. Therefore, the date by which firms should actively mobilise implementation projects and the magnitude of those projects is uncertain.

Feedback on this first consultation (and final text of the Handbook and Binding Technical Standards) will not be available until early January 2019 or later. The second consultation from the FCA (published 23 November) could also include additional requirements for changes at exit day making it difficult for firms to confidently predict overall resourcing requirements. The PRA is also consulting on potential changes. The CP questions relating to the required timeline to implement specific changes cannot be answered in isolation as the overall combined impact of change will drive the timeline. Indeed, without a detailed impact assessment by firms, which would require significant resources, and which firms have not initiated following consistent HMT and FCA advice not to prepare now to implement these changes by March 2019, there may well be risks that have not yet been identified and do not therefore appear in this response.

A key concern is the volume of amendments: responding to and implementing the changes will be labour intensive, operationally challenging and time-consuming. There are also a large number of dependencies due to the interconnected relationships of industry actors (firms, venues, middleware providers, etc). Once implemented there will also need to be pre-deployment testing both at company and at industry level. Insufficient time for implementation of the proposed changes in the CP and/or relevant Statutory Instruments represents a significant risk to compliance and operational continuity on exit day.

We therefore believe that the FCA should minimise, in line with the FCA's statutory requirements, all changes that require firms, their clients and industry utilities (e.g. ARMs) to make temporary or permanent changes to business/operational processes and systems for 29 March 2019. AFME proposes that **only the changes necessary for the continued pursuit of the FCA's statutory objectives should be brought in on exit day**, with the remainder being introduced at a later stage, in a phased in manner and only if a detailed cost benefit analysis shows they are worthwhile. AFME would appreciate the opportunity to discuss these operational practicalities with the FCA.

AFME requests that the FCA set out, as soon as it is able to do so, its intentions in terms of the use of its transitional powers in the event that there is no implementation period. Information on how the FCA would act in that situation will be useful to firms though we appreciate that the FCA may not be able to provide such clarity until the terms of the withdrawal are clearer.

Clear and timely communication with industry as to how the phase-in should operate, with further consultation on an ongoing basis, will be vital for a successful transition into the new UK regime, allowing senior managers to be clear as to their responsibilities and appropriate changes be made to compliance procedures.

2. ***Do you agree that we have correctly identified all relevant amendments in our draft Handbook and BTS text related to the cross-cutting issues set out above? Do you have any other points you wish to raise regarding our approach to these cross-cutting issues?***

Chapter 3 of the consultation explains the FCA's approach to cross-cutting issues (i.e. issues which affect multiple parts of the Handbook and Binding Technical Standards). The consultation sets out the policy approach to the following cross-cutting issues:

- The position of EU law and how it relates to the Handbook (paragraphs 3.7 to 3.13)
- The loss of passporting rights (paragraphs 3.14 to 3.20)
- References to EU institutions (paragraphs 3.21 to 3.22)
- References to 'other member/EEA states' and 'other competent authorities' (paragraph 3.23)
- References to information sharing with the ESAs or 'other competent authorities' (paragraph 3.24)

In each case, we consider that the policy rationale for amendments is appropriate.

In the time available and given the volume of amendments, it is challenging to provide a view on whether all relevant amendments have been identified. It will be important for there to be the opportunity to raise additional points at a later stage.

3. ***Are there any proposed changes reflected in the instruments in Appendix 1 that are not cross-cutting in nature (see Chapter 3) or discussed in this chapter where you think we should re-consider our approach? If so, why?***

We have highlighted in our responses to questions 9, 11 and 14 some proposed changes to the Handbook where we think the FCA should re-consider their approach. Our concerns are as follows:

COBS 2 – paragraphs 4.26 to 4.28 of the consultation

COBS 2.4.4R and 2.4.5G provide rules and guidance under which a firm (F1) may rely on a suitability assessment or an appropriateness assessment performed by another firm (F2). Currently, a firm may rely on such assessments performed by investment firms authorised in an EEA state.

The FCA proposes to make changes (set out for reference in Appendix A to this response) so that a firm may only rely on assessments performed by UK authorised investment firms.

AFME considers that this is not an essential change and could introduce unnecessary operational complexity. We therefore suggest that firms should continue to be able to rely on assessments performed by an investment firm authorised in an EEA state.

COBS 3 – paragraphs 4.29 to 4.30 of the consultation

As a general point, our answers assume that UK firms will have the necessary licences to operate in the EU 27 and will be able to serve their EU clients.

COBS 3.5.3ER (set out for reference in Appendix A to this response) provides rules and guidance under which a firm may treat a non-UK local public authority or municipality as an elective professional client. The test currently makes a distinction between EEA and non-EEA public authorities.

The FCA proposes to change the test so that EEA public authorities are treated in the same way as third country public authorities.

AFME suggests that the FCA should not make this change. During the move to MiFID II some local authorities were adversely affected by suddenly being classified as retail clients. It would be important to avoid a similar detrimental impact as a result of the FCA's proposed changes.

COBS 10 – paragraphs 4.31 to 4.35 of the consultation

COBS 10.4.1R and 10.5.5G (set out for reference in Appendix A to this response) provide rules and guidance that, subject to conditions, a firm providing a service consisting only of execution and/or reception and transmission of orders in particular financial instruments and which is provided at the initiative of the client is not required to assess appropriateness.

One of the conditions for defining non-complex financial instruments is that market prices are made available by valuation systems independent of the issuer. The current guidance refers to valuation systems overseen by a depositary that is regulated as a provider of depositary services in an EEA state.

The FCA proposes to make changes so that the guidance only refers to depositaries regulated in the UK.

AFME proposes that the guidance should refer to depositories regulated in either the UK or in an EEA state.

The FCA's proposal to amend FUND and COLL to remove references to a depositary of an authorised fund that is a UK branch of an EEA firm – Question 11 of the consultation

AFME's view is that the proposal is counterproductive from an investor protection, administrative and cost perspective.

The proposal would require depositaries that fall into this category to obtain authorisation under the temporary permissions regime and transfer their business to a UK incorporated entity. Of primary concern is that such new entities are not required to be credit institutions and need only comply with minimal capital requirements outlined in COLL and FUND, thereby detracting from the protection currently enjoyed by investors in UK collective investment schemes ("CIS") receiving depositary services from highly capitalised credit institutions. The ability of a depositary to stand over its obligations to return lost assets is particularly important given the "strict liability" standard to return lost assets imposed by AIFMD and UCITS V, which standard we assume will be retained in UK regulation post Brexit. UK Investor protection will therefore be considerably eroded by the proposal.

Of secondary importance, yet highly impactful, is the administration and cost involved in transferring depositary services to a new legal entity. In the first instance it will require a re-registration and account revision for all assets held in custody, through custody chains globally. All assets and cash that are not held in custody will require review and amendment, to both governing documentation and accounts. Finally, in addition to amending their depositary agreements, CIS will not only have to obtain authorisation from UK regulatory authorities to appoint a new depositary, but also either notify or obtain express approval from regulatory authorities where the CIS are distributed. In many domiciles this can be a costly and protracted process.

Communication with clients

COBS 4.5A provides rules and guidance on communicating with clients.

COBS 4.5A.10 states that where the information contains an indication of past performance of a financial instrument, a financial index or an investment service, investment firms shall ensure that the following conditions are satisfied:

"… (e) where the indication relies on figures denominated in a currency other than that of the Member State in which the retail client or potential retail client is resident, the currency is clearly stated, together with a warning that the return may increase or decrease as a result of currency fluctuations;"

The FCA proposes to replace this with:

"… (e) where the indication relies on figures denominated in a currency other than pounds sterling, the currency is clearly stated, together with a warning that the return may increase or decrease as a result of currency fluctuations;"

The current provisions work well for all clients including UK residents and would continue to do so after Brexit. The proposed change would be a confusing switch for non-UK clients as well as expensive for firms to implement. We would therefore suggest no change.

4. ***Are there any proposed changes where you think we should not follow the baseline approach of treating the EEA as a third country? If so, why?***

Paragraph 2.12 of the consultation states that:

"The Treasury has made clear that in amending legislation under the EU Withdrawal Act, it will work on the basis that, if there is no withdrawal agreement, the UK cannot rely on any new specific arrangements being in place between the UK and the EU. The Treasury therefore would, in general, treat the EU and its member states in the same way as it treats non-EU or third countries after exit day (the baseline approach)." Paragraph 2.13 of the consultation states that "However, the Treasury has made clear that there are instances where it will diverge from this approach where it is necessary. …To ensure consistency across the wider legislative framework, we are taking the same approach."

We have highlighted in our responses to questions 12 and 14 where following the baseline approach would create costs and reduce efficiencies without benefit; particularly for changes to time, currency and personal identifiers. Our concerns are set out in the box at the end of our response to question 4.

Other issues will arise in relation to the MiFID transparency regime which will be dealt with in more detail in our responses to FCA CP 18/36.

Issues may be created as a result of adopting the baseline approach, for example treating EEA firms and venues exactly as any other third country may result in the EU27 being unable to grant or even initiate assessments for equivalence under the existing ruleset (which for example requires reciprocity for the derivatives trading obligation equivalence determinations). It might be more pragmatic to recognise that in fact the EEA's regime is aligned with the UK's, at least for the moment.

We would argue that a more appropriate approach would be to achieve an outcome which most closely resembles the way that financial regulation operates currently, i.e. requiring minimal operational change in relation to the very finely tuned existing regulatory framework, much of which went live as recently as January of this year (MiFID II).

References to CET

Paragraph 5.29 contains a reference to the FCA's general onshoring approach of replacing references to Central European Time (CET) with references to Greenwich Mean Time (GMT) and British Summer Time (BST).

Paragraph 5.29 goes on to state that *"in RTS 23 Commission Delegated Regulation (EU) No 2017/585, we are not proposing to follow the general onshoring approach in respect of references to time zones … because we recognise that changing this deadline would otherwise effectively reduce the time we have for processing the data and may have cost and system implications for firms."*

Article 2 of RTS 23 is provided below:

"Timing for provision of reference data to competent authorities

Trading venues and systematic internalisers shall provide their competent authority by 21.00 CET each day they are open for trading with the reference data for all financial instruments that are admitted to trading or that are traded, including where orders or quotes are placed through their system, before 18.00 CET on that day."

We consider that the FCA is right to keep the references to CET in RTS 23.

We think that more generally the FCA should avoid changing references from CET to BST and/or GMT unless there is a compelling supervisory justification for doing so and should adopt a consistent approach throughout the Handbook. Changing the time references for firms' activities such as transaction reporting, best execution and others from CET to BST and/or GMT will raise significant implementation challenges, as firms have built their MiFID reporting systems based on references to CET. This is particularly relevant for transaction reporting as the obligation relates to both UK and EU instruments and transactions in EU instruments will need to be reported to both the FCA and to the relevant EEA regulator where the trade is between a UK and EU counterparty.

These challenges also apply to changes which in principle would provide UK firms with an extra hour to satisfy certain reporting obligations (e.g. a reference to a report being completed by a designated GMT/BST time as opposed to CET time). Such changes would lead firms to incur adaptive costs which may not be necessary for the FCA to carry out its supervisory functions effectively.

Transaction reporting

Paragraph 5.30 states that:

"More generally, in the case of transaction reporting, RTS 22 maintains the application of reporting requirements to the same categories of UK firms. Whilst the amendments to RTS 22 and 23 are technical in nature, UK firms should note that these changes have the following effects:

- *UK trading venues will have to report transactions on their venue by EEA firms as they will become third-country firms and will not have an obligation to report to the FCA. They should not, however, report for UK branches of EEA firms as after exit day these should be reporting to the FCA. Trading venues will therefore need to distinguish trading by the UK branch from elsewhere where the branch is not executing*

- *A UK firm will no longer be able to meet the conditions for transmission if they transmit orders to an*

EEA firm. They will therefore have to either report transactions themselves or ensure their transmission arrangements are with firms that have obligations to report to the FCA

- *The FCA will publish consolidated data on instruments traded on UK trading venues and systematic internalisers and may publish other reference data"*

It is difficult for AFME to provide a full scope of possible impacts that the FCA's proposed changes to transaction reporting could have on firms until we analyse the second FCA Brexit consultation on, inter alia, firms' transparency-related obligations.

AFME understands that the UK FIRDS will be available for firms to use by 29 March 2019. Firms will need to be provided with the specifications of UK FIRDS well in advance of 29 March 2019 in order to update their systems and avoid a cliff edge situation.

AFME requests that the FCA communicates to industry that over-reporting (ie continued reference to the ESMA FIRDS) would be an acceptable approach in the interim period between the UK FIRDS becoming operational and firms reengineering their downstream systems and processes reliant upon the database.

Transaction reporting – personal identifiers

Article 6 of Commission Regulation 2017/590 (RTS 22) specifies that a natural person shall be identified in a transaction report using the designation resulting from the concatenation of the 2-letter country code of the nationality of the person, followed by the national client identifier listed in Annex II based on the nationality of the person.

Article 6(3) states that *"Where a natural person is a national of more than one EEA country, the country code of the nationality when sorted alphabetically by its ISO …code and the identifier of that nationality assigned in accordance with paragraph 2 shall be used. Where a natural person has a non-EEA nationality, the highest priority identifier in accordance with the field referring to 'all other countries' provided in Annex II shall be used. Where a person has EEA and non-EEA nationality, the country code of the EEA nationality and the highest priority identifier of that nationality assigned in accordance with paragraph 2 shall be used."*

The FCA proposes to amend Article 6(3) to read: *"Where a natural person is a national of more than one country, the country of the nationality which appears first in the [ISO … code] column in Annex II and the identifier of that nationality assigned in accordance with paragraph 2 shall be used."*

In our view this change should not be made because it may have a detrimental impact on the quality of data received in the reports and would be difficult for firms to implement as it will require changes to firms' reporting systems, HR systems and client databases (e.g. an individual will have a different identifier under onshored UK MiFIR and a different identifier under EU 27 MiFIR).

For example, in relation to a natural person who is a dual UK and EEA country national, it is possible that the designation of the natural person could be different under UK law and under the law applicable in the EEA country. Specifically, where the EEA country of which the natural person is a citizen was previously above the UK (marked as *"GB"*) in Annex II to the technical standards and would now, for the UK onshored regime, be below *"GB"* under the amended Annex II, the identifier for that person would be different under the UK onshored rules in comparison to the EEA rules. For example, under the UK onshored rules, a firm would be required to report a UK national insurance number whereas under the EEA regime, a firm would

be required to report the relevant personal identifier. Surveillance systems based on the identifier would therefore not detect that the transactions were carried out by the same person.

In addition, even if a Withdrawal Agreement is not reached between the UK and the EU 27, we expect that European authorities (including UK authorities) will cooperate in detecting and deterring market abuse. The FCA's proposed changes would therefore make it more difficult for firms and regulators to detect market abuse.

The changes being proposed in Article 6 could lead to firms incurring significant costs and dedicating significant resources to obtaining personal information from individuals. In order to comply with the FCA's proposed changes on personal data, firms will need to re-investigate the natural person population (decision makers, agents and clients) to determine whether they are dealing in in-scope financial instruments, re-validate existing personal data held in relation to all natural persons in order to ensure that they are complying with the new requirements under UK law as well as maintaining, where applicable, compliance with other rules, obtain consent and source new pieces of personal data, store that information and then adjust reporting systems so that they are able to populate the correct piece of personal data on the relevant report. Firms would have to take legal advice on matters ranging from privacy and sharing of information across borders to conflicts of law.

AFME understands that if firms will not be able to switch off trade and transaction reporting systems referencing EU instruments, then it would be acceptable for firms to continue to operate using those systems. Even this measure would present significant challenges as firms would need to take legal advice relating to matters that are outlined in the paragraph above.

AFME proposes that firms to be permitted to mask certain data fields that are captured under existing regulations but will not be required under the FCA's proposed changes, or which are required under the FCA's proposed changes, but the provision of that information would put the firm in breach of the laws or regulations of a third country. Firms would then be able to submit such reports (with affected data fields being masked) to the UK regulators.

5. Do you agree with our proposal to amend the term 'regulated market' as it applies in INSPRU?

AFME is not responding to this question.

6. Do you agree we should continue to permit exposure to stock-lending transactions with EEA-authorised counterparties on the same basis as under the current rules in INSPRU 3.2?

AFME is not responding to this question.

7. Do you agree we should continue to allow exposure to stock-lending transactions with EEA-authorised counterparties on the same basis as under the current rules in COBS 21.3?

AFME is not responding to this question.

8. Do you agree we should continue to allow exposure to loans or deposits made with an approved financial institution on the same basis as under the current rules in COBS 21.3?

AFME is not responding to this question.

9. Do you agree with our proposed changes to COBS 2, 3, 6, 9, 10 and 22?

COBS 2 – paragraphs 4.26 to 4.28 of the consultation

COBS 2.4.4R and 2.4.5G provide rules and guidance under which a firm (F1) may rely on a suitability assessment or an appropriateness assessment performed by another firm (F2). Currently, a firm may rely on such assessments performed by investment firms authorised in an EEA state.

The FCA proposes to make changes (set out for reference in Appendix A to this response) so that a firm may only rely on assessments performed by UK authorised investment firms.

AFME considers that this is not an essential change and could introduce unnecessary operational complexity. We therefore suggest that firms should continue to be able to rely on assessments performed by an investment firm authorised in an EEA state.

COBS 3 – paragraphs 4.29 to 4.30 of the consultation

As a general point, our answers assume that UK firms will have the necessary licences to operate in the EU 27 and will be able to serve their EU clients.

COBS 3.5.3ER (set out for reference in Appendix A to this response) provides rules and guidance under which a firm may treat a non-UK local public authority or municipality as an elective professional client. The test currently makes a distinction between EEA and non-EEA public authorities.

The FCA proposes to change the test so that EEA public authorities are treated in the same way as third country public authorities.

AFME suggests that the FCA should not make this change. During the move to MiFID II some local authorities were adversely affected by suddenly being classified as retail clients. It would be important to avoid a similar detrimental impact as a result of the FCA's proposed changes.

COBS 6, 9 and 22 – paragraphs 4.36 to 4.40 of the consultation

COBS 6.4 and 9.4 set out disclosure requirements relating to sales of packaged products to retail clients in the EEA. COBS 22 sets out restrictions on distribution of products such as CoCo (Contingent Convertibles) funds to retail clients in the EEA.

The FCA proposes to amend the provisions to refer only to retail clients in the UK. The FCA notes that firms may be subject to EEA local laws instead.

AFME agrees with the proposed changes.

COBS 10 – paragraphs 4.31 to 4.35 of the consultation

COBS 10.4.1R and 10.5.5G (set out for reference in Appendix A to this response) provide rules and guidance that, subject to conditions, a firm providing a service consisting only of execution and/or reception and transmission of orders in particular financial instruments and which is provided at the initiative of the client is not required to assess appropriateness.

One of the conditions for defining non-complex financial instruments is that market prices are made available by valuation systems independent of the issuer. The current guidance refers to valuation systems overseen by a depositary that is regulated as a provider of depositary services in an EEA state.

The FCA proposes to make changes so that the guidance only refers to depositaries regulated in the UK.

AFME proposes that the guidance should refer to depositories regulated in either the UK or in an EEA state.

10. Do you agree that UK UCITS schemes should have the same freedom to invest in EEA (non-UK) assets as they do now?

We agree that UK UCITS schemes should have the same freedom to invest in EEA (non-UK) assets as they do now.

11. Do you agree with our proposal to amend FUND and COLL to remove references to a depositary of an authorised fund that is a UK branch of an EEA firm?

AFME's view is that the proposal is counterproductive from an investor protection, administrative and cost perspective.

The proposal would require depositaries that fall into this category to obtain authorisation under the temporary permissions regime and transfer their business to a UK incorporated entity. Of primary concern is that such new entities are not required to be credit institutions and need only comply with minimal capital requirements outlined in COLL and FUND, thereby detracting from the protection currently enjoyed by investors in UK collective investment schemes ("CIS") receiving depositary services from highly capitalised credit institutions. The ability of a depositary to stand over its obligations to return lost assets is particularly important given the "strict liability" standard to return lost assets imposed by AIFMD and UCITS V, which standard we assume will be retained in UK regulation post Brexit. UK Investor protection will therefore be considerably eroded by the proposal.

Of secondary importance, yet highly impactful, is the administration and cost involved in transferring depositary services to a new legal entity. In the first instance it will require a re-registration and account revision for all assets held in custody, through custody chains globally. All assets and cash that are not held in custody will require review and amendment, to both governing documentation and accounts. Finally, in addition to amending their depositary agreements, CIS will not only have to obtain authorisation from UK regulatory authorities to appoint a new depositary, but also either notify or obtain express approval from regulatory authorities where the CIS are distributed. In many domiciles this can be a costly and protracted process.

12. Do you foresee any specific challenges in implementing the changes described above?

References to CET

Paragraph 5.29 contains a reference to the FCA's general onshoring approach of replacing references to Central European Time (CET) with references to Greenwich Mean Time (GMT) and British Summer Time (BST).

Paragraph 5.29 goes on to state that *"in RTS 23 Commission Delegated Regulation (EU) No 2017/585, we are not proposing to follow the general onshoring approach in respect of references to time zones … because we recognise that changing this deadline would otherwise effectively reduce the time we have for processing the data and may have cost and system implications for firms."*

Article 2 of RTS 23 is provided below:

"Timing for provision of reference data to competent authorities

Trading venues and systematic internalisers shall provide their competent authority by 21.00 CET each day they are open for trading with the reference data for all financial instruments that are admitted to trading or that are traded, including where orders or quotes are placed through their system, before 18.00 CET on that day."

We consider that the FCA is right to keep the references to CET in RTS 23.

We think that more generally the FCA should avoid changing references from CET to BST and/or GMT unless there is a compelling supervisory justification for doing so and should adopt a consistent approach throughout the Handbook. Changing the time references for firms' activities such as transaction reporting, best execution and others from CET to BST and/or GMT will raise significant implementation challenges, as firms have built their MiFID reporting systems based on references to CET. This is particularly relevant for transaction reporting as the obligation relates to both UK and EU instruments and transactions in EU instruments will need to be reported to both the FCA and to the relevant EEA regulator where the trade is between a UK and EU counterparty.

These challenges also apply to changes which in principle would provide UK firms with an extra hour to satisfy certain reporting obligations (e.g. a reference to a report being completed by a designated GMT/BST time as opposed to CET time). Such changes would lead firms to incur adaptive costs which may not be necessary for the FCA to carry out its supervisory functions effectively.

Transaction reporting

Paragraph 5.30 states that:

"More generally, in the case of transaction reporting, RTS 22 maintains the application of reporting requirements to the same categories of UK firms. Whilst the amendments to RTS 22 and 23 are technical in nature, UK firms should note that these changes have the following effects:

- *UK trading venues will have to report transactions on their venue by EEA firms as they will become third-country firms and will not have an obligation to report to the FCA. They should not, however, report for UK branches of EEA firms as after exit day these should be reporting to the FCA. Trading venues will therefore need to distinguish trading by the UK branch from elsewhere where the branch is not executing*

- *A UK firm will no longer be able to meet the conditions for transmission if they transmit orders to an EEA firm. They will therefore have to either report transactions themselves or ensure their transmission arrangements are with firms that have obligations to report to the FCA*

- *The FCA will publish consolidated data on instruments traded on UK trading venues and systematic internalisers and may publish other reference data"*

It is difficult for AFME to provide a full scope of possible impacts that the FCA's proposed changes to transaction reporting could have on firms until we analyse the second FCA Brexit consultation on, inter alia, firms' transparency-related obligations.

AFME understands that the UK FIRDS will be available for firms to use by 29 March 2019. Firms will need to be provided with the specifications of UK FIRDS well in advance of 29 March 2019 in order to update their systems and avoid a cliff edge situation.

AFME requests that the FCA communicates to industry that over-reporting (i.e. continued reference to the ESMA FIRDS) would be an acceptable approach in the interim period between the UK FIRDS becoming operational and firms reengineering their downstream systems and processes reliant upon the database.

Coordination of systems changes for market participants

Changes to systems may need to be made the across buyside, sellside and venues, to ensure that systems properly interconnect.

Changes to a firm's transaction reporting operational processes and infrastructure (e.g. the introduction of reporting for UK branches of EEA firms) will need to be coordinated and tested with the firm's ARMs. The implementation timeline will be therefore be dependent on both the firm's and the ARM's readiness for industry testing and will be longer than if the changes were independent.

13. ***How long do you anticipate it will take to implement the changes? Please describe which changes you are referring to.***

It is difficult to assess precisely how long it will take to implement the changes. Firms may be in a better position to assess this once there is greater certainty. There exists a dependency upon whether the FCA chooses for the onshoring changes to be delivered on a single date, as was the case with MiFID II, or phased-in over an extended period, as was the case with SFTR and Benchmarks Regulation. With a phased-in approach the industry will be able to focus resource on the first tranche of changes and so deliver those more quickly than a situation in which all of the changes are required to be delivered at the same time.

AFME would appreciate the opportunity to engage with the FCA on this topic.

14. ***Are there any other impacts that you have identified?***

Transaction reporting – personal identifiers

Article 6 of Commission Regulation 2017/590 (RTS 22) specifies that a natural person shall be identified in a transaction report using the designation resulting from the concatenation of the 2-letter country code of the nationality of the person, followed by the national client identifier listed in Annex II based on the nationality of the person.

Article 6(3) states that *"Where a natural person is a national of more than one EEA country, the country code of the nationality when sorted alphabetically by its ISO …code and the identifier of that nationality assigned in accordance with paragraph 2 shall be used. Where a natural person has a non-EEA nationality, the highest priority identifier in accordance with the field referring to 'all other countries' provided in Annex II shall be used. Where a person has EEA and non-EEA nationality, the country code of the EEA nationality and the highest priority identifier of that nationality assigned in accordance with paragraph 2 shall be used."*

The FCA proposes to amend Article 6(3) to read: *"Where a natural person is a national of more than one country, the country of the nationality which appears first in the [ISO … code] column in Annex II and the identifier of that nationality assigned in accordance with paragraph 2 shall be used."*

In our view this change should not be made because it may have a detrimental impact on the quality of data received in the reports and would be difficult for firms to implement as it will require changes to firms' reporting systems, HR systems and client databases (e.g. an individual will have a different identifier under onshored UK MiFIR and a different identifier under EU 27 MiFIR).

For example, in relation to a natural person who is a dual UK and EEA country national, it is possible that the designation of the natural person could be different under UK law and under the law applicable in the EEA country. Specifically, where the EEA country of which the natural person is a citizen was previously above the UK (marked as *"GB"*) in Annex II to the technical standards and would now, for the UK onshored regime, be below *"GB"* under the amended Annex II, the identifier for that person would be different under the UK onshored rules in comparison to the EEA rules. For example, under the UK onshored rules, a firm would be required to report a UK national insurance number whereas under the EEA regime, a firm would be required to report the relevant personal identifier. Surveillance systems based on the identifier would therefore not detect that the transactions were carried out by the same person.

In addition, even if a Withdrawal Agreement is not reached between the UK and the EU 27, we expect that European authorities (including UK authorities) will cooperate in detecting and deterring market abuse. The FCA's proposed changes would therefore make it more difficult for firms and regulators to detect market abuse.

The changes being proposed in Article 6 could lead to firms incurring significant costs and dedicating significant resources to obtaining personal information from individuals. In order to comply with the FCA's proposed changes on personal data, firms will need to re-investigate the natural person population (decision makers, agents and clients) to determine whether they are dealing in in-scope financial instruments, re-validate existing personal data held in relation to all natural persons in order to ensure that they are complying with the new requirements under UK law as well as maintaining, where applicable, compliance with other rules, obtain consent and source new pieces of personal data, store that information and then adjust reporting systems so that they are able to populate the correct piece of personal data on the relevant report. Firms would have to take legal advice on matters ranging from privacy and sharing of information across borders to conflicts of law.

AFME understands that if firms will not be able to switch off trade and transaction reporting systems referencing EU instruments, then it would be acceptable for firms to continue to operate using those systems. Even this measure would present significant challenges as firms would need to take legal advice relating to matters that are outlined in the paragraph above.

AFME proposes that firms to be permitted to mask certain data fields that are captured under existing regulations but will not be required under the FCA's proposed changes, or which are required under the FCA's proposed changes, but the provision of that information would put the firm in breach of the laws or regulations of a third country. Firms would then be able to submit such reports (with affected data fields being masked) to the UK regulators.

Communication with clients

COBS 4.5A provides rules and guidance on communicating with clients.

COBS 4.5A.10 states that where the information contains an indication of past performance of a financial instrument, a financial index or an investment service, investment firms shall ensure that the following conditions are satisfied:

"… (e) where the indication relies on figures denominated in a currency other than that of the Member State in which the retail client or potential retail client is resident, the currency is clearly stated, together with a warning that the return may increase or decrease as a result of currency fluctuations;"

The FCA proposes to replace this with:

"… (e) where the indication relies on figures denominated in a currency other than pounds sterling, the currency is clearly stated, together with a warning that the return may increase or decrease as a result of currency fluctuations;"

The current provisions work well for all clients including UK residents and would continue to do so after Brexit. The proposed change would be a confusing switch for non-UK clients as well as expensive for firms to implement. We would therefore suggest no change.

Short selling regulation

Under the EU SSR, there are exemptions from the reporting requirements, the buy-in regime and restrictions on uncovered short selling for shares which are principally traded in a third country.

We note that the FCA will assume ESMA's duty for collating and publishing the list of shares principally traded in a third country. To ensure continuity, the FCA states that they may recognise ESMA's existing list for up to two years following exit day.

We would appreciate confirmation from the FCA and early notification of the FCA's final approach.

We would welcome any additional information on the status of the *"appropriate cooperation arrangements"* as referred to in Article 8(g) of the Binding Technical Standard.

We note the reference in Article 12(1)(a) that *"any calculations determining the principal trading venue are made as soon as possible after the relevant circumstances arise and in respect of the two-year period preceding the date of calculation"* and suggest that it would be more accurate to refer to a date that reflects the new UK regime. A similar point arises in respect of Article 9.

15. ***Do you agree that we have correctly identified all relevant amendments in our draft BTS text related to the cross-cutting issues set out in Chapter 3? Are there any proposed changes in the instruments in Appendix 2 or discussed in Chapter 5 where you think we should reconsider our approach?***

In the time available it is difficult to determine whether the FCA has correctly identified all relevant amendments.

In our responses to questions 12, 13 and 14 we have identified some proposed changes where we think that the FCA should reconsider its approach.

It will be important for the FCA to have a process for dealing with any issues which are identified at a later stage.

16. Do you have any comments on the proposed guidance on our approach to EU Level 3 materials set out at Appendix 3 to this CP?

Paragraph 8 of Appendix 3 states that "*the EU derived law to which the non-legislative material relates has largely been retained. We therefore consider that the EU non-legislative material will remain relevant post exit day to the FCA and market participants in their compliance with regulatory requirements…*"

Paragraph 9 of Appendix 3 (relating to pre-exit material) states that "*the FCA's supervisory expectations in respect of Guidelines and Recommendations remains the same.*"

Paragraph 13 of Appendix 3 states that "*Where the FCA has informed the relevant ESAs that it would not comply with part or all of a pre-exit Guideline, we will continue with this approach.*"

Paragraph 17 of Appendix 3 states that "*The FCA may consider materials produced by the ESAs post exit, including where pre-exit material is updated. Where we consider it appropriate to do so, we will set out our expectations as to how it is to be treated.*"

We think this guidance is helpful and appropriate. We understand that materials produced by the ESAs after the UK's withdrawal from the EU will not constitute UK guidance, and that the FCA will need to consider (for example) whether to amend its Handbook references.

17. Have you identified any specific provision in EU non-legislative material which should be specifically reviewed and amended because you think that the interpretive approach proposed will not be enough to ensure the regulatory framework remains fit for purpose? If so, please explain why you think this is the case.

Paragraph 6.5 of the CP states that "*We will not carry out a detailed line-by-line review of all existing level 3 materials to identify and resolve provisions which no longer have their intended effect.*"

Paragraph 18 of Appendix 3 states that *"EU non-binding materials may include references which no longer have their intended effect… In these situations, we expect firms and other market participants to sensibly and purposively interpret EU non-binding material…"*

In the time available it was not possible to review the existing Level 3 materials, but AFME would be pleased to discuss with the FCA how to engage in such a review at a later stage.

Appendix A – text of relevant legislation and guidance

COBS 2.4 - suitability assessments and appropriateness assessments

Reliance on other investment firms: MiFID and equivalent business

2.4.4 R (1) This *rule* applies if a *firm* (F1), in the course of performing *MiFID or equivalent third country business*, receives an instruction to provide an *investment* or *ancillary service* on behalf of a *client* (C) through another *firm* (F2), if F2 is:

…

(b) an *investment firm* that is:

(i) a *firm* ~~or authorised in another *EEA State*~~; and

(ii) subject to equivalent relevant requirements.

…

2.4.5 G (1) If F1 is required to perform a suitability assessment or an appropriateness assessment under *COBS* 9A or *COBS* 10A, it may rely upon a suitability assessment performed by F2, if F2 was subject to the requirements for assessing suitability in *COBS* 9A (excluding the *basic advice rules*) ~~or equivalent requirements in another *EEA State*~~ in performing that assessment.

(2) If F1 is required to perform an appropriateness assessment under *COBS* 10A, it may rely upon an appropriateness assessment performed by F2, if F2 was subject to the requirements for assessing appropriateness in *COBS* 10A.2~~, or equivalent requirements in another *EEA State*~~ in performing that assessment

COBS 3.5 – treating a non-UK public local authority as an elective professional client

3.5.2 E R (1) A *firm* may treat a non-*UK* local public authority or municipality as an *elective professional client* if it complies with *COBS* 3.5.3R(1) and *COBS* 3.5.3R(3) and, in addition, applies the ~~relevant~~ "quantitative test" ~~under paragraph (2)~~ that is applied in relation to *MiFID or equivalent third country business* under *COBS* 3.5.3R(2).

~~(2) The relevant "quantitative test" under this *rule* is either:~~

~~(a) where the local public authority or municipality is established in an *EEA State* and the *EEA State* has adopted alternative or additional criteria to those listed in the fifth paragraph to section II.1 of annex II to *MiFID*, those criteria as set out in the law or measures of that *EEA State*; or~~

~~(b) in any other case the same "quantitative test" that is applied in relation to *MiFID or equivalent third country business* under *COBS*~~

~~3.5.3R (2).~~ [deleted]

3.5.3R (2)
in relation to *MiFID or equivalent third country business* in the course of that assessment, at least two of the following criteria are satisfied:

1. (a)
   the *client* has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters;
2. (b)
   the size of the *client*'s *financial instrument* portfolio, defined as including cash deposits and *financial instruments*, exceeds EUR 500,000;
3. (c)
   the *client* works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged;

COBS 10.1 – valuation systems overseen by a depositary that is regulated in an EEA state

COBS 10.1.4R (1)
A *firm* is not required to ask its *client* to provide information or assess appropriateness if:

1. (a)
   the service only consists of execution and/or the reception and transmission of *client* orders, with or without *ancillary services*, it relates to particular *financial instruments* and is provided at the initiative of the *client*;
2. (b)
   the *client* has been clearly informed (whether the warning is given in a standardised format or not) that in the provision of this service the *firm* is not required to assess the suitability of the instrument or service provided or offered and that therefore he does not benefit from the protection of the *rules* on assessing suitability; and
3. (c)
   the *firm* complies with its obligations in relation to conflicts of interest.

2. (2)
   The *financial instruments* referred to in (1)(a) are:
   1. (b)
      money market instruments, bonds or other forms of securitised debt (excluding those bonds or securitised debt that embed a *derivative*); or
   2. (d)
      other non-complex *financial instruments*.
3. (3)
   A *financial instrument* is non-complex if it satisfies the following criteria:
   1. (a)
      it is not a *derivative* or other security giving the right to acquire or sell a *transferable security* or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures;
   2. (b)
      there are frequent opportunities to dispose of, redeem, or otherwise realise the instrument at prices that are publicly available to the market participants and that are either market prices or prices made available, or validated, **by valuation systems independent of the issuer**;
   3. (c)

it does not involve any actual or potential liability for the *client* that exceeds the cost of acquiring the instrument; and

4. (d)
adequately comprehensive information on its characteristics is publicly available and is likely to be readily understood so as to enable the average *retail client* to make an informed judgment as to whether to enter into a transaction in that instrument.

COBS 10.5.5G

The circumstances in which valuation systems will be independent of the issuer (see *COBS 10.4.1 R (3)(b)*) include where they are overseen by a depositary that is regulated as a provider of depositary services in a *EEA State*.

References to CET in Binding Technical Standards – from Appendix 2 of the CP

Annex O
COMMISSION IMPLEMENTING REGULATION (EU) 2017/953 of 6 June 2017 laying down implementing technical standards with regard to the format and the timing of position reports by investment firms and market operators of trading venues pursuant to Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments

Article 1

Reporting deadlines

Market operators and investment firms operating trading venues shall send the competent authority the weekly report referred to in point (a) of that Article regarding the aggregate positions held at the close of business of each week no later than Wednesday 17.30 GMT or BST (where applicable) of the following week.

Where either Monday, Tuesday or Wednesday of the week in which that report is to be submitted is not a working day for the market operator or investment firm referred to in the first paragraph, that market operator or investment firm shall submit the report as soon as possible and no later than Thursday 17.30 GMT or BST (where applicable) of that week.

Annex F

COMMISSION DELEGATED REGULATION (EU) 2017/585 of 14 July 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the data standards and formats for financial instrument reference data and technical measures in relation to arrangements to be made by the European Securities and Markets Authority and competent authorities

Article 2

Timing for provision of reference data to the competent authority

> Trading venues and systematic internalisers shall provide the competent authority by 21.00 CET each day they are open for trading with the reference data for all financial instruments that are admitted to trading or that are traded, including where orders or quotes are placed through their system, before 18.00 CET on that day.

Appendix B – drafting points/clarifications

Drafting comments on the Glossary

Page 3/110	*EU CRR* – reads 'the EU version' should this be UK version?
Page 14/110	*authorised person* – will there be a different approach/definition for TPR firm authorisation?
Page 22/110	*competent authority* – under point (11) is the reference to Article 40 of the EU benchmark regulation correct?
Page 22/110	*consolidated tape provider* – under point (a) should the reference to APAs instead be 'UK APAs' in line with UK MTF and UK OTFs?
Page 57/110	*market making activities* – AFME welcomes the new definition but would welcome confirmation that this maintains the FCA's current position in respect of membership. The drafting was a little unclear
Page 57/110	*market making activities* – there is an 'or' missing at the end of (i)

Drafting comments on the COBS sourcebook

Notwithstanding the definition of "the relevant rules" given in COBS 3.7.3B(UK), Article 71(2) of the MiFID Org regulation, we would welcome further clarification.

Drafting comments on the SYSC sourcebook

We note the proposed changes as set out in SYSC:

> Article 22 (1)
> Investment firms shall establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the firm to comply with its obligations under ~~Directive 2014/65/EU~~ UK law on markets in financial instruments ("UK obligations"), as well as the associated risks, and put in place adequate measures and procedures designed to minimise such risk and to enable the competent authorities to exercise their powers effectively under ~~that Directive~~ UK law on markets in financial instruments.
>
> Investment firms shall take into account the nature, scale and complexity of the business of the firm, and the nature and range of investment services and activities undertaken in the course of that business.
>
> Article 25 (1)
> Investment firms shall, when allocating functions internally, ensure that senior management, and, where applicable, the supervisory function, are responsible for ensuring that the firm complies with its obligations under ~~Directive 2014/65/EU~~ UK law on markets in financial instruments ("UK obligations"). In particular, senior management and, where applicable, the supervisory function shall be required to assess and periodically review the effectiveness of the policies, arrangements and procedures put in place to comply with the ~~obligations under Directive 2014/65/EU~~ UK obligations and to take appropriate measures to address any deficiencies.

> The allocation of significant functions among senior managers shall clearly establish who is responsible for overseeing and maintaining the firm's organisational requirements. Records of the allocation of significant functions shall be kept up-to-date.

Our understanding is that in each case this defines the term "UK obligations" to mean a firm's "obligations under UK law in markets in financial instruments".

The term "UK law on markets in financial instruments" is itself undefined and could in theory be interpreted broadly, but given that it replaces a reference to "Directive 2014/65/EU" (i.e. MiFID) we understand that it should be read narrowly. We would welcome confirmation on this point.

We note that the term "UK law on Markets in Financial instruments" also appears in a number of other places, e.g. Article 30, Article 31 and Article 32 of SYSC, COBS 3.3.1A UK, COBS 11.7A.5 UK, COBS 12.2.17 UK, COBS 12.2.18 UK and COBS 16A.5.1 UK.

We would again welcome confirmation that the term should be read narrowly.

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