Initial IMA comments on draft MiFID II and MiFIR

IMA's overall position on these measures is that we welcome the review of the original MiFID. In considering the detailed provisions, we believe that the watchword should be whether they serve the interests of users of markets, that is, issuers and investors.

Attached are appendices covering five broad areas:

Appendix 1 – market provisions

Appendix 2 – third country provisions

Appendix 3 – investor protections

Appendix 4 – transaction reporting

Appendix 5 – corporate governance

These are still initial positions, and further analysis may throw up further points. Nor have we sought at this stage to propose revised language, but will aim to do so in due course. Subject to those caveats, the main points on which we would seek changes are as follows:

- **Market provisions**. We believe that the proposals for pre-trade transparency will not be in investor interests. While ostensibly about greater transparency, in reality they would impose an untried and untested market structure which we fear could have unintended consequences, for example in reduced liquidity.

  It needs to be made clear that the provision on algorithmic trading strategies does not apply to portfolio managers using these techniques to execute trades on behalf of clients.

- **Third country**. We understand from Commission officials that it is intended to treat delegation of portfolio management to third countries and the use of third country brokers as passive marketing. We support this, but the draft is unclear on this matter and we would like to see more explicit language.

  We believe the requirement for service providers to set up branches, with the associated equivalence and reciprocity provisions, are onerous and may lead to retaliation. This could be damaging and expensive for UCITS managers exporting funds outside the EU. We think the AIFMD approach of requiring providers to comply with relevant EU law is preferable.

  The proposals involve erosion of the distinction between "professional" and "retail" investors. This would have very significant adverse impacts for our members (eg in seeking to be treated as professionals – as opposed to eligible counterparties – when placing orders with brokers in order to secure best execution for their clients) while providing no additional benefit for underlying investors.

- **Investor protection**. We think the ban on inducements for independent advisers only will have perverse consequences. While we understand the Commission's fears that banks would end open architecture if they could not receive inducements, this merely serves to highlight the pressing need to tackle distribution practices in European banks.

  We are comfortable with the provisions on complex UCITS as they stand, but consider that any extension beyond structured UCITS should be considered in the context of the forthcoming UCITS V directive.

  We have no issue in principle with ESMA and national regulators having powers to restrict or ban the marketing of specific products to retail investors, but we are concerned about the balance of powers as between ESMA and national regulators, and the lack of transparency or accountability in the decision-making process. Also, the powers should not be used to circumvent EU cross border obligations (eg in relation to UCITS).

- **Transaction reporting**. There needs to be clarity that asset managers are not required to report transactions when they are already being reported by brokers.

- **Corporate governance**. These provisions need proportionate application. In particular the restriction on the number of directorships is too inflexible; it should be sufficient to rely on the requirement for "sufficient time and resources"

Investment Management Association

December 2011

Appendix 1

MiFID and MiFIR – market provisions

Key issues

MiFID1 sought to introduce greater competition into European financial markets and thus support growth and stability. The measure of success was in consequence principally focused on the extent to which the dealers and infrastructure providers reorganised and grew financial markets business between themselves. **MiFID II and MiFIR, by contrast, should have their success measured according to the benefit that they deliver to the real economy, focusing therefore on the impact they have – positive or negative - on investors and issuers.** Both of the legislative proposals should be read and assessed in this light.

Whilst we support the introduction of post-trade transparency, **we strongly oppose the proposed measures for regulating pre-trade transparency in non-equity markets.** We consider these proposals to have negative effect as follows:

- Whilst presented as bringing greater transparency of information to these markets, the legislation in reality introduces change to the actual structure of working markets. The proposal has not sought to evaluate the proposed changes other than in the light of introducing greater transparency. It is therefore deficient in its assessment of impact, in particular with regard to the impact on market users such as investors.
- Investors value information about real market trades (post trade data). They place much less value on pre-trade information as only the smallest trades are likely to permit reliance on the information published (we therefore have no issue with introducing rules on pre-trade information for retail customers). Non-equity markets still have heavy reliance on dealer liquidity and whilst this may change over time, which we do not oppose, it has not changed yet and should not be changed other than to improve market resilience.
- Imposing a market structure that is, to all intents and purposes, a "snapshot" of the equity market structure at a point in time is insensitive to differences in asset types and to real, working, markets. Investors need markets in order to give effect to investment management decisions. Experimenting with the shape of markets should be undertaken with considerable caution as the risk of damage – that the markets cease to continue to function effectively - is high. Should these markets be damaged, the impact would flow into the real economy, via higher costs and reduced ability to manage risks.
- Imposing changes to pre-trade data at the same time as introducing better quality post-trade data means that it will be difficult or impossible to work out the impact of either change – and therefore make adjustments in the future with any degree of certainty about their effect.

What we like

Equity

- The proposals to require a working consolidated tape for post-trade data, through the use of APAs and CTPs [Article 11-12 MiFIR, 61 etc MiFID]. We support the need for harmonised standards. We also support commercial solutions for CTPs in principle, but fear there will be no sufficient commercial driver for comprehensive CTPs to emerge and still consider the Commission should be equipped to mandate a single authoritative tape in case events prove that necessary. As the provision of consolidated equity trade data has been a concern since the implementation of MiFID, time should be of the essence in progressing this work.
- Fair access to venues and market infrastructure providers, thus supporting choice for investors and other market users without putting the quality of the services provided at risk [Article 28].
- We welcome the greater focus on market surveillance across all venues.

Fixed income and OTC derivatives

- The post-trade transparency proposals for fixed income and OTC derivative markets are welcomed [Articles 9, 20 MiFIR]. Investors place reliance on good quality data providing information about real executed trades.
- Delegating the detailed post-trade work to ESMA and the Commission (for example to calculate parameters for waivers for large in scale trades) makes sense, as this work is highly technical in nature. It also allows for flexibility to adjust parameters should market conditions change year on year.
- It is imperative that post-trade data is designed to be consolidated from the outset. Investors would not support provisions that, for example, nominally put competition between market intermediaries ahead of efficient, accurate and complete data transmission to market users.

Other

We support the provisions on fair access between venues and clearing houses, all of which should improve market resilience [Article 38-40, 57 MiFID2].

What we don’t like

Equity

- We can see arguments in favour of the proposed OTF provisions for equity markets [Articles 7-8 MiFIR] in terms of the prohibition on the use of proprietary capital inside a broker crossing network. But we are concerned that imposed as a rule and applied to all possible future OTFs is disproportionate. Instead, the OTF provisions should be amended to require the broker/dealer first to make it clear if it ever participates in its own crossing network, then to provide that a client may always decline to allow any interaction with the broker's own market-making in the pool and finally require detailed disclosure to the client setting out how trades generally as well as its own in OTFs have been filled (therefore post trade, indicating the respective weighting of client versus dealer liquidity utilised in the system).

Fixed income and OTC derivatives

- We oppose the proposed pre trade transparency provisions for non-equity markets in a general sense [Articles 7-8 MiFIR].
- We cannot support an approach which, whilst presented as bringing greater pre-trade transparency to these markets, in reality forces change to the market infrastructure and provision of services by market intermediaries (banks, brokers, infrastructure providers) with no assessment of the expected impact. It is not in investors' interests to put at risk a long standing market operation for an experiment in equity-like transparency.
- We accept that the Commission is responding to G20 commitments to bring much financial market trading on to organised trading venues. We do not accept that this has to be done by pre-specifying the shape of the market and requiring participants to operate within these constraints. We also believe it significantly underplays the real role of good quality post-trade data – an area in which MiFID 1 was also remiss.
- We oppose the prohibition on the use of proprietary capital in OTFs. This prohibition is likely to prove damaging to dealer-led liquidity, on which clients place significant reliance in all financial markets but especially fixed income and OTC derivatives. Instead, we would urge transparency from broker to client setting out how trades have been filled (therefore post trade, indicating client versus dealer liquidity).

Other

- Algorithmic trading provisions are expressed in terms that could capture many firms other than those doing High Frequency Trading. The definition, as drafted, could potentially catch fund managers using electronic systems to manage their orders [Article 4(3) MiFID2]. We have no objection to the need for proper systems and controls and business continuity but portfolio managers undertake only client business and therefore would never be in a position to meet the obligations to post quotes [Article 17(3)]; by contrast, they are giving effect to the decisions of the portfolio manager on behalf of underlying clients.
- High Frequency Traders bring valued liquidity to markets, but by the same token they can, if no control is exerted, cause markets to be disrupted by rapid price movements. This has been a problem in exchanges (including the US "flash crash"). Whilst additional controls are desirable, we note that exchanges should already have the means to deal with market disruption caused by HFTs. Investors would like regulators to seek to solve the problem now with existing powers, rather than wait until MiFID2 is in effect.

Appendix 2

MiFID II – New prohibitions on using 3rd country firms

In order to meet obligations to act professionally and in the best interests of clients and even to meet suitability requirements, EU asset managers frequently need to use the services of firms based outside the EU (**"3rd country firms").** As an example, where the manager wishes to buy a security in an emerging market it may have to use a local exchange member (and national clearing arrangements may require that). Also managers routinely delegate all or part of the management of a portfolio to local experts. This may be within or outside their own groups.

These two common arrangements, the use of a 3rd country broker and the use of a 3rd country manager delegate, are referred to throughout this paper.

Currently under MiFID there is no requirement for 3rd country firms to obtain an EU authorisation in order to provide EU managers with such services. The EU manager remains responsible to the client to meet its EU regulatory obligations and has to ensure that these are achieved through its arrangements with 3rd country firms.

Similarly, under AIFMD, EU AIFMs may delegate to 3rd country managers which have no EU authorisation. However, an AIFM can only do so under rigorous delegation requirements, designed to ensure that its obligations are not altered by the delegation. Under AIFMD, the 3rd country manager must be authorised by a regulator which meets the IOSCO standards for securities regulation.

MiFID II as it stands would change both these positions. A 3rd country broker providing execution services to an EU firm would appear to be providing a core service under MiFID II whether the EU firm is a MiFID investment firm, an AIF manager under the AIFMD or a UCITS manager under UCITS IV. As MiFID II imposes far more onerous requirements than AIFMD or UCITS, it will govern what is allowed. This is a major change and will override the AIFMD dossier work.

Accordingly, in the remainder of this note, the term "**EU manager**" is used to signify a MiFID investment firm, an AIF manager under the AIFMD or a UCITS manager under UCITS IV.

We think there are major practical problems with the proposal, and these are so significant that they could result in the perverse outcome that investors' interests are in fact undermined. The approach is also inconsistent with the approach taken in AIFMD where the initial proposal that third country delegates must be authorised was rejected and a much more pragmatic approach adopted.

Scope of MiFID II proposals

There are two sets of provisions on third country firms providing MiFID services into the EU:

- Articles 41 to 46 of MIFID, which deals with the provision of services to retail clients, and requires (inter alia) that a branch is established and that the third country meets equivalence and reciprocity requirements. The Commission has since stated to IMA that these provisions are intended to apply to professionals as well.
- Articles 24 and 34-36 of MiFIR, which deals with the provision of certain services to eligible counterparties and imposes higher requirements of equivalence and reciprocity.

The practical problems

a. Where an EU manager receives discretionary management services from a 3rd country manager delegate, the EU manager must be categorised as a professional client (by default) or a retail client. Either way, the MiFID II proposals would require the delegate to establish a branch in the EU. It is patently unworkable to expect a firm, perhaps in Taiwan or South Africa, to which management is being delegated to do that. We describe in the Annex why the other requirements (equivalence and reciprocity, membership of a compensation scheme, compliance with many MiFID rules) will be unworkable in practice.
b. Where an EU manager receives execution services from a 3rd country broker, the EU manager is categorised as an eligible counterparty by default. In this case the broker must meet the high equivalence and reciprocity standards and the Annex identifies why this will be unworkable in practice. However, it must be noted that in practice EU managers demand treatment as professional clients from brokers, especially as otherwise they are owed no duty of best execution which can benefit their clients. So on current practice 3rd country brokers would in fact also need to establish a branch in the EU in order to deal with EU Managers.
c. The intention to apply the same regulatory regime to professional investors as to retail investors is problematic. This assumption does not take into account the resources and the ability professional investors have to assess delegates and counterparties they are dealing with. They are in a very different position in this respect to retail investors. Professional investors such as asset managers, however, generally do not want to opt up to eligible counterparty status so as not to lose the benefit of best execution from their counterparties, given their duties to underlying investors.

Whilst we note that recital 74 states that EU persons might receive services "at their own exclusive initiative" without the requirements of the Directive applying, this does not meet the concerns of the industry. First the status of the recital is very unclear given the clear substantive requirements of the Directive. Secondly, it does not apply to the proposed Regulation. Thirdly, it is impracticable to limit any interaction to "exclusive" initiatives. Perhaps a manager receives marketing material from the US broker stating how its execution provides better quality; this would be exactly the sort of firm the EU manager may need to consider for best execution purposes under MiFID.

Solutions

Exempt asset manager delegates

3rd country firms to whom asset management[1] has been delegated by an EU manager should be exempt from the requirement to be directly MiFID authorised themselves. The EU manager owes obligation to its clients under MiFID, UCITS or AIFMD and will continue to do so despite its choice to delegate some part of the mandate. As under AIFMD this delegation should not be seen as a loophole given the existing requirements which already lie on EU mangers which prevent them from delegating their duties so that they become letter box entities (E.G. Article 20.3 AIFMD, Article 13.2 UCITS and Article 14.1 MiFID Level 2). Compliance will be achieved by contractual obligations under outsourcing agreements – there is no need for an additional overlay. The delegation requirements under MiFID II should be brought into line with those under AIFMD, as should the delegation requirements under UCITS.

Exempt third country brokers when used by EU managers

We believe that an identical approach should be adopted here; it should be sufficient to rely on the contractual arrangements between the asset manager and the third party. So there should be a specific exemption for third country brokers executing orders passed on by an asset manager acting under a client mandate.

Amend recital 74

The Commission confirmed recently to IMA that the intention was that delegation of asset management would fall within Recital 74 – so out of scope of MiFID II - in that they were provided at the exclusive initiative of the EU firm.

We would suggest therefore that this Recital is also amended to cover these activities and also to make it clear that contact [to professional investors] in the course of existing arrangements is out of scope.

Other services

A range of other asset management related services will also be impacted by the MiFID II third country proposals: notably, situations where a client appoints a third country manager direct, or where a non-EU distributor sells products into the EU, or where an EU fund of funds invests in offshore funds. Unlike with the previous examples, the third country firm will be engaging direct with the underlying client, and there will be no intermediation by a MiFID authorised entity acting in a fiduciary capacity under a client mandate.

In such cases we broadly support the approach in MiFID II (in particular that the firm be authorised and subject to EU conduct of business requirements). But, for the reasons given below in the Annex, there needs to be a **more pragmatic approach** with regard to equivalence, reciprocity and physical presence:

[1] Asset management includes discretionary portfolio management an d related execution of orders, risk management and investment advice on a client portfolio.

- There should be no reciprocity requirement. If equivalence is to then it must be very high level – as in Article 37 of AIFMD it should at most provide for 'equivalent rule[s] having the same regulatory purpose and offering the same level of protection to investors'. Alternatively an approach such as under the Level 2 ESMA advice on delegation under AIFMD (which provides that the third country authority must be fully compliant with the IOSCO principles for securities regulation) would be better.
- A physical presence in the form of a branch should not be necessary; but if the firm chooses not to set up a branch then for retail clients it is reasonable to require the firm to appoint a representative (being a regulated firm) as a point of contact and for handling complaints etc. This mirrors the approach in AIFMD. Whether the firm does business remotely or via a branch, it is important to ring-fence the EU business so that the whole of the third country's business is not subject to both EU and the third country requirements.

ANNEX

Equivalence, reciprocity and branch issues

***Equivalence*:** We agree that equivalence and reciprocity are laudable objectives; but they cannot be achieved quickly and unilaterally. Any move towards common standards should follow a top-down approach – i.e. the standards should be set by IOSCO, and not be set and imposed extra–territorially by local regulators. The latter approach will lead to an increasingly protectionist stance, severely curtail investor choice, and could even (if it requires existing arrangements to be unravelled) fundamentally destabilise financial markets.

EU and third country regulatory frameworks have been developed with common objectives in mind, such as investor protection, and the need to equip regulators with the information and tools necessary to monitor and respond to systemic risk. However, the regulatory approaches to those objectives are in reality quite different in various jurisdictions. Specific requirements under the different regimes will have evolved over time and reflect domestic historical developments.

This is recognised by IOSCO in its Technical Committee Principles for Supervisory Co-operation. Page 14 of the IOSCO paper states: "For jurisdictions that have adopted a form of shared oversight (for example, a form of mutual recognition, or a home-host model), cooperation can take the form of leaving supervision of the foreign-based entity entirely to the home regulator. This type of cooperation is predicated on a common or comparable set of laws and rules and a legal regime that supports such an approach. However, in some other instances, such an approach may not be legally possible or practically feasible. *Indeed, different regulators with whom a regulated entity is registered often administer and enforce differing regulatory and supervisory regimes."* [Our emphasis]

The reality is that even in highly-regulated jurisdictions such as the USA, it will not be feasible to find an "equivalent" US provision for every EU requirement. Conversely, there may be specific requirements under US law for which there are no equivalent EU provisions. ***A critical issue here is that the proposed rules refer to reciprocal recognition of the prudential framework and including sufficient capital requirements. This seems to have been drafted with banking entities in mind. While international convergence of regulatory capital is likely at a global level under Basel III, there is no such global standard for other investment firms who do not deal using their own capital such as asset managers. For example, US managers are not subject to capital requirements and so could not satisfy the criteria set out in Article 41(3).***

It is notable that under the two Directives where equivalence has already been introduced (Solvency II and CRAs), ESMA and EIOPA are struggling to achieve the equivalence assessment in the necessary timelines and transitional arrangements are having to be put into place.

So, if there is to be an equivalence requirement in MiFID, it should be outcomes-based – for example, the third country regime must have similar objectives with regard to financial stability and investor protection. Alternatives such as AIFMD Article 37.2 (b) (which provides such a high level approach) or the Level 2 ESMA advice on delegation under AIFMD (which provides that the third country authority must be fully compliant with the IOSCO principles for securities regulation) would be better. But to take it further will not work.

***Reciprocity*:** For the same reason, reciprocity is over ambitious at this stage. It is important to recognise that no authority may exist in third countries for supervisors to provide equivalent reciprocal recognition. For example, in the USA, the U.S. Securities and Exchange Commission does not have the authority to permit registration of an investment adviser on a different basis than US firms (and therefore permit non-US firms not to have to comply with the requirements of US law) on the basis that a firm is subject to legally binding rules of equivalent effect to U.S. law. Further, there may be applicable US state laws. This can pose a problem in that states can impose requirements on investment adviser representatives (supervised persons who have more than 5 and more than 10% of natural person clients other than "qualified clients," i.e. high net worth clients) who have a place of business in a particular state. States can impose qualification and licencing requirements on these employees and there is no mechanism for the SEC to preempt state requirements in these circumstances.

In addition, provisions in existing trade agreements typically include commitments regarding access and national treatment for foreign firms, not access based on conditions for the existence of rules of equivalent effect and equivalent reciprocal recognition.

Branch: often the requirement for a geographic presence has led to disagreements in trade agreement negotiations. It is discriminatory, particularly against smaller firms. And it could also lead to retaliatory measures. For instance, it is common for third countries to require that a UCITS manager wanting to distribute into that jurisdiction has to appoint a representative in that jurisdiction as a point of contact for clients. If they were to require the establishment of a branch, this would significantly increase costs of exporting UCITS to third countries, which would have an adverse impact on EU GDP.

Appendix 3

Provisions to Ensure Investor Protection

Adviser charging (Article 24(5))

We agree that there have been failures in the mass retail marketplace that need to be addressed and that rules in this area need to be improved.

What is clear is that many retail consumers do not have a real understanding of the inducements paid on an ongoing basis to intermediaries and/or their purpose. Indeed, many are unaware that such payments are made at all, having received no more than a statement hidden in the "small print" of the original contract that refers to a very small percentage being deducted from their investment to pay the intermediary.

We therefore agree that current arrangements regarding inducements are inadequate. We do not agree, though, that disclosure *per se* has failed or that a ban is warranted at this stage.

Instead, we suggest that intermediaries be required to provide regular statements (eg annually) to their clients, perhaps in a standardised format, of the <u>amounts</u> they receive from different product providers from or out of their investments in particular products in which they are invested. This would remind consumers that such payments are being made and give them an immediate understanding of the amounts involved. The Commission might also consider whether ongoing payments should be allowed other than where ongoing service is being provided.

Whatever the nature of the final requirements, it essential that they should apply to <u>all</u> advice-givers. To apply rules narrowly to those circumstances where advice is offered on an independent basis would not be sufficient to protect investors from conflicts of interest. The Commission's proposal (to ban inducements only for independent advisers) is predicated on the supposed potential for advice to be affected adversely by inducements and leading to mis-selling and product bias. However, such inducements are not confined to the area of independent advice, howsoever this is defined. Financial inducements of many kinds, including volume over-ride, target bonuses, and rewards related to specific product sales, are prevalent in the non-independent advice sector. It is just as likely that mis-selling or product bias leading to consumer detriment could occur in this dependent advice sector. And there is evidence in a number of markets that this is the case.

Moreover, the introduction of a ban only for independent advisers could lead to a shift of advisers toward non-independent status, which would result in a severe limitation of choice available for consumers, market distortion, pricing differentials and increased confusion on the part of consumers.

Inducement ban on portfolio managers (Article 24(6))

In principal we have no strong objection, but we do want to ensure that the intent not to interfere with CSAs and research provision is implemented. Current wording ought to achieve this due to the reference only to monetary benefits.

Complex UCITS (Article 25.3 a)(4))

Identifying only structured UCITS as complex is acceptable. Any further changes to the complex/non-complex border must be left to discussions in UCITS V which can then take a more holisitic (and evidenced) approach to the issues.

Product Intervention by ESMA (Article 31) and CAs (Article 32)

We do not object but we ask for much clearer accountability in ESMA's decision making and rights to make representations or challenge the decisions (we would see this a little used back-stop protection but one that is essential to protect against abuse of power).

Client categorisation (Annex II)

We note that it is proposed that local public authorities are now by default retail clients. We would not have asked for this change as it will increase the cost of some services (due in part to the mandated reporting requirements that may not fit local authority needs).

We do not support however the proposal to allow each member state to adopt its own criteria for assessing whether a local authority has the necessary expertise and knowledge to be a professional. We do not see the need for additional criteria compared with the MiFID test applying to all other retail clients that can be opted-up to professional status. But if there are to be additional criteria then at the very least they should be harmonised at ESMA.

Execution of orders (Article 4)

We support the changes to the definition of execution of orders on behalf of clients (in Article 4 MiFID). It is a key part of introducing necessary duties on banks which issue structured products from their balance sheets.

Eligible counterparties

We support the extended duties (of honesty etc) owed to ECPs introduced in Article 30 MiFID.

PRIPs

IMA welcomes the inclusion of structured deposits in Article 1(3) of the Directive and the higher level of investor protection granted by this measure. Depending on the detailed proposals on PRIP disclosures and IMD II expected to be published in the first quarter of next year, it may be that we shall have additional or amended comments to make on those parts of the MiFID II proposals that relate to the PRIPs initiative.

Appendix 4

TRANSACTION REPORTING UNDER MiFIR

Overview

The Commission's proposals contain revised provisions on transaction reporting by investment firms in Recitals 27-29 and Articles 21 to 23 of MiFIR.

A Regulation is deemed necessary for transaction reporting to avoid variations on the national level which would lead to market distortions and regulatory arbitrage, preventing the development of a level-playing field. The imposition of a Regulation ensures that the requirements will be directly applicable to investment firms and promotes a level-playing field. The FSA will have no power to 'interpret' the legislation into rules.

Transaction reporting under MiFID enables supervisors to monitor the activities of investment firms under MiFID and to monitor for abuses of the Market Abuse Directive (MAD). Transaction reporting is also useful for general market monitoring.

Main Changes

The scope of transaction reporting will be substantially extended and aligned with the scope of market abuse rules, also currently being revised. The only instruments escaping the requirement will be instruments (i) not admitted to trading nor traded on an MTF or OTF, (ii) whose value does not depend on that of a financial instrument admitted to trading or traded on an MTF or OTF, and (iii) the trading of which cannot have an impact on an instrument admitted to trading nor traded on an MTF or OTF.

The provisions will require better identification of clients on whose behalf the investment firm has executed the transaction and the persons responsible for its execution.

Double reporting of trades under MiFID and EMIR will be avoided as trade repositories will be required to transmit reports to the competent authorities.

Main Issue for Asset Management Firms

Art 23(1) requires transaction reports of 'investment firms which execute transactions in financial instruments'. There is no explicit reference to any exemption for asset managers, nor anything in the articles about a proportionate response to transaction reporting.

This could result in asset managers being required to transaction report every transaction they place, to the relevant regulator.

Problems with this approach

- There is no definition of 'execution': in order for firms to know what they should report this must be defined properly.
- There is no definition of 'client': under the current FSA approach asset managers need not identify the underlying client on whose behalf they are making decisions to deal, as the discretion lies with the asset manager. The current draft does not make it clear that this approach will continue. Art 23(3) requires the report to identify the client 'on whose behalf the investment firm has executed that transaction'.

Potential solutions

- Recital 27 of MiFIR notes the need to 'avoid an unnecessary administrative burden on investment firms' and Recital 29 states that 'double reporting of the same information should be avoided'. Taken together these could be taken as to indicate a recognition that firms should not be required to make transaction reports to regulators that the regulators would not find useful. The FSA have already made it clear that where brokers' reports contain all the necessary information about a trade, then they gain nothing by having asset managers duplicating this information.

  If this approach can be reproduced in MiFIR, or the ESMA regulatory technical standards then this would avoid unnecessary administrative burdens and double reporting.

  The proposal are required to, and are said to, take full account of the principle of proportionality, being adequate to reach the objectives and not going beyond what is necessary in doing so. The proportionality principle requires them to take into account the right balance of public interest at stake and the cost-efficiency of the measure. In as much as they currently impose a transaction reporting requirement on asset managers that would only duplicate transaction reports being submitted by brokers then this does not enhance the public interest. It imposes extra costs (which will be passed to investors) on asset managers, it burdens regulators with unnecessary and unwanted duplicate reports and it does nothing to enhance the public interest.

  Article 40 of MiFIR states that in implementing the transaction reporting requirements MiFIR must accord with the principle of proportionality, as set out in Article 5 of the Treaty on European Union by not going beyond what is necessary in order to achieve the objectives of MiFIR.

- MiFIR should make it clear that, as the purpose of the transaction reporting requirements is to catch market abuse, the 'client' for these purposes is the party with discretion. For portfolio managers this would normally be themselves rather than their underlying client.

Appendix 5

MiFID II – Corporate Governance Issues

Background

Recitals 38-39 and Article 9 of MiFID II introduce new, expanded requirements on the management bodies of investment firms. While many of these are sensible, high level requirements, others are overly detailed, onerously specific and unworkable.

Key issues

Whilst we support the introduction of revised high level standards for management bodies, and recognise that many of these are picked up from CRD IV, **we strongly oppose the more onerous, detailed restrictions on the number of directorships to be held by individuals.** We consider these proposals to have negative effect as follows:

- Investment Trust Companies and Unit Trusts will not be counted within the intro-group allowance.
- External directorships, e.g. of charities or property management companies, would use up the permitted number of directorships.

What we like

High level requirements that management bodies are to have adequate knowledge, skills and experience.

Where appropriate and proportionate the nomination committee is to be made up of NEDs. There will, of course, be many situations where this is neither appropriate nor proportionate, e.g. for small subsidiary asset management companies which do not have any non-executive directors, or for partnerships which have no directors.

What we don't like

Restrictions on the number of directorships to be held – although we note that Competent Authority can authorise more depending on the individual circumstances, nature, scale and complexity of the investment firm's activities

- Limits on executive directorships & non-executive directorships cause problems for Investment Trust and Property Fund directors. We consider that the directive should stick to high level requirements on members of management bodies having 'sufficient time and resources'.

Requirements on promoting gender, age, educational, professional and geographical diversity. It is incumbent on all management bodies to ensure that they have the appropriate experience to discharge their responsibilities and meet anti-discrimination legislation; imposing these extra requirements seems likely only to produce unnecessary paperwork and tokenism.

We also query why MiFID seeks to impose stricter Corporate Governance than exist in other industries?

Other

There needs to be consistency with Corporate Governance elements of other directives, e.g. AIFMD, CRD IV etc. It should be noted that CRD IV is already demanding very similar requirements so why have it in both (though there are a few non-CRD MiFID firms, not our members, more in the commodity area). Compliance with CRD should be enough. Requiring firms to comply with several very similar, but slightly different, sets of requirements is going to lead to considerable unnecessary effort and expense, with no consequent benefit to investors, or market stability. The directives ought to be revised so that they cross-refer, as necessary, to one source of appropriate and proportionate governance requirements.