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FCA's Latest Papers on the Implementation of MiFID II

Fifth Consultation Paper and first Policy Statement issued, with the FCA's second Policy Statement due in June.

The FCA has just published two further papers on its approach to implementing MiFID II. The first, which is the FCA's fifth Consultation Paper, covers Occupational Pension Schemes, changes to the decision making and enforcement guides, and reporting positions in commodity derivatives (CP17/8). The second contains near final rules (following earlier consultations) on markets issues, taping telephone conversations, systems and controls, client assets and commodity position limits (PS17/5).

By and large, the FCA confirms that it will implement MiFID II in the way that its earlier Consultation Papers envisaged. The near final rules are largely unchanged. There are, however, a number of points of detail that have implications of some significance for certain firms. These are:

- **Transaction reporting by portfolio managers and pension firms**. The FCA has retained its (somewhat surprising) original rule change that these firms will not be required to transaction report unless they are also MiFID firms.

- **Telephone taping**. The FCA seems set to introduce its rules relating to corporate finance business as previously proposed, but will only finalise this position in its June Policy Statement. In the meantime, the FCA proposes additional flexibility for Retail Financial Advisors who are exempt from MiFID (and not all will be), who are required either to tape all relevant conversations or take a written contemporaneous note. The June Policy Statement will contain more detail on what must be included in that note.

- **MTFs**. The FCA proposes guidance to make clear that an MTF can execute orders against its own proprietary capital and engage in matched principal trading outside the MTF it operates, and interact with the order flow within that MTF.

- **OTFs**. The FCA declines to give further guidance on the meaning of "discretionary", saying that this must await publication of Level 3 Q&A by ESMA. The FCA does, however, say that "discretion must be a key and essential component of the operating of the OTF".

- **Non-EEA branches**. In a section on Systematic Internalisers, the FCA makes a worrying forward-looking reference to a future decision by the EEA joint committee on the application of MiFID II to non-EEA branches. Our view is that there are a limited number of circumstances (which are made clear in MiFID II itself) where MiFID II conduct requirements apply to non-EEA branches, and we are concerned that any future paper could expand on this requirement beyond the actual wording in the legislation.

- **Notification of rule breaches**. The FCA has maintained its earlier position that any MiFID rule breach must be notified, removing any element of materiality from Principle 11 in relation to MiFID business. So, for example, a single transaction report that was incorrect would require notification.

- **Conflicts of interest**. The FCA plans to implement revised conflicts of interest rules in the way described in previous Consultation Papers. However, the FCA again strays into a broader discussion on the use of disclosure as a means of managing conflicts. The FCA references its previous guidance on Payment For Order Flow (PFOF), which is perhaps unfortunate given the trenchant nature of its approach to that topic. Any guidance on conflicts generally that is given in the context of PFOF is likely to be similarly uncompromising. The FCA states that firms should "*only use disclosure as a means of last resort. Disclosing a conflict of interest is not a form of managing that conflict of interest. A firm should … only disclose a conflict when the firm's administrative and organisation arrangements have failed in this regard*". The FCA's approach seems to presuppose that either a means of managing a conflict will manage it absolutely and disclosure is therefore unnecessary, or a means of managing a conflict will completely fail to achieve its objective and therefore leave disclosure as the only means (the "last resort"). Much more commonly, steps will be put in place to mitigate the potential risks of a conflict, but still leave a disclosure obligation. It is to be hoped that the FCA will show more flexibility when supervising firms where the firm feels that disclosure may be necessary, under English law, as an additional means of managing a potential conflict.

Firms therefore await the FCA's final package of implementing measures in June, along with further ESMA Level 3 Q&A, which should enable the final rules to be published six months before MiFID II comes into effect. Given the complexity of MiFID II, most firms will have, at least in part, needed to front-run final publication of these rules in order to get going with their MiFID II implementation projects, so firms will be hoping there are no major surprises in June.

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