DEONTEA
REGULATORY INTELLIGENCE AND QUALITY ASSURANCE SOLUTIONS

ESMA Consultation paper

Draft technical standards on the provision of the investments services and activities in the Union by third-country firms under MiFID II and MiFIR.

Response by

DEONTEA Ltd

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Overview

This response has been prepared on behalf of Deontea Ltd. Deontea Ltd is a highly specialised firm providing tailored regulatory intelligence and quality assurance solutions to the financial industry participants. We operate in the UK, EU and Switzerland. We advise a variety of clients (Investment firms, Asset Managers, Credit Institutions, Payment services, Fund Companies, RegTech or FinTech Firms) in connection to regulatory matters and act as an additional resource in that field. We support firms in meeting their regulatory obligations with confidence, and obtain assurance that their systems and controls are proportionate, fit for purpose while staying business friendly.

We welcome the opportunity to comment on this consultation paper. As set out above, we advise a variety of clients who vary in size and sector and some of our collaborators have been instrumental in the design of the current regulatory frameworks whilst working at the NCAs. As such, our views are reflective of the issues and difficulties our clients face to comply with ESMA rules and of the understanding we have of the regulatory rule making. Please note that we include only answers to those questions where we have chosen to respond.

Q1: Do you agree with the list of information to be requested by ESMA from applicant third-country firms for registration in the ESMA register? If no, which items should be added or deleted and for which reasons? Please provide detailed answers.

Whilst the list of information to be requested by ESMA from applicant firms is comprehensive and correspond to the information to be provided under Article 46 of MiFIR as amended by the IFR to allow ESMA and/or NCAs to monitor those firms' activities within the EU, it may benefit from some adjustments.

We assume that the content of information to be provided at registration will be equivalent to the content of the annual reporting as it will facilitate comparisons and monitoring. From firm's perspective it will allow creating a consolidated process to collect the mandatory information and identify any changes as required by the annual reporting.

Consequently we would suggest the following amendments:

a) information identifying the third-country firm

In fields 7 & 8, a postal address is requested and it is specified that the firm shall provide that address if it is different from the Head Office address. You may want to specify that what you are looking for is the operating address from where the services will be provided if different from the registered address. It is consistent with the way firms are reporting on their activities.

b) name and contact details of the person in charge of the application

The application will probably be filled and submitted by the Compliance department and/or legal, whilst it is important to be provided with a contact details for the firm, we believe that it is a technical information that doesn't really provide any specific insights as all such applications are always filled by those departments and that you are requesting to be provided with details on the compliance function in section 23.

We would suggest that this should be amended and/or supplemented with a request to be provided with the name and details of the person within Senior Management &/or Board who is ultimately responsible for the oversight/control of the activities that will be carried out within the EU (Governance related information).

e) information on the investment services, investment activities and ancillary services to be provided in the Union, together with the expected numbers of clients and/or counterparties and total net turnover;

We understand that this section is meant at providing information of the type of business the firm wishes/expects to carry-out within the EU. We believe that it would be beneficial to also request information on the type of clients the firm will be servicing, i.e. target market including whether the firm will be providing services to both professional clients and eligible counterparties or to only one of those categories.
Depending on the outcome, the type of policies and arrangements in place will have to be different and will have to be assessed accordingly.

f) information on how the activities of the third-country firm in the Union will contribute to the strategy of the third-country firm or, where relevant, its group;

When a firm applies for authorisation, it must provide the relevant NCA with an operational business plan. Whilst the requested information under Article 46 of MiFIR as amended by the IFR covers numerous areas, no information is requested on the firm operational model and other arrangements/systems that will be used by the firm to provide investment services and/or carry-out investment activities (e.g. IT, Business continuity). We believe that to ensure the adequate level of investor protection and orderly functioning of the markets, it is important to understand how and from where if relevant those activities and services will be carried-out/provided. We propose to supplement this section with some consideration on that subject matter.

i) description of the investor protection arrangements of the third-country firm, including:

iv. where the third-country firm executes orders for its clients, the arrangements of the third-country firm to execute such orders on terms most favourable to the client

The wording should be amended to read "where the …. on behalf of its clients" or alternatively where the firms executes orders or decision to deal ~~for its clients~~ …" to be consistent with MiFID II wording of Article 27. Please note that you may want to clarify within the description of subfields within section 14 that it also applies to RTO and Portfolio management services.

x. the arrangements of the third-country firm to protect and manage the funds and assets of its clients;

We understand that what is requested in that sub field is a description of the arrangements the firm has implemented to safeguard financial instruments and funds belonging to clients in accordance with the principle enacted by the Delegated Directive 2017/593, Chapter II. The wording should be amended to read "the arrangements … to ~~protect and manage~~ safeguard the financial instruments and funds of its clients" for consistency purpose and to provide third country firms with the appropriate regulatory reference. The current wording may be misleading; especially the use of the word "managing" may refer to other part of the regulatory framework.

As indicated above, the provided list seems to be quite exhaustive, hence there is no mention of the arrangements the third-country firm has adopted in relation to "reporting to clients". MiFID II has introduced numerous requirements including in connection to costs & charges, periodic reporting and other similar features. It is part of the transparency framework introduced to provide investors with sufficient information to be able to challenge their service providers and select the most suitable ones. It may be interesting to require some information on reporting standards to ensure that investors will be provided with sufficient data and to level the playing field between EU firms and third-country firms to avoid unfair competition and lack of transparency.

Also, within the annual information, the Firm has to provide information on persons with a qualifying holding; hence there is no mention of such information to be provided at registration. For consistency purposes this should be amended.

Q2: Taking into account the list of information in Article 46(6a) of MiFIR, as amended by the IFR, do you agree with the list of information that third-country firms providing investment services and investment activities in the Union in accordance with Article 46 of MiFIR should report to ESMA on an annual basis? If no, which items should be added or deleted and for which reasons? Please provide detailed answers.

We believe that the information provided on annual basis should be as close as possible to the initial information submitted at registration. It will allow ESMA and firms to monitor any material changes that took place if any. Therefore we believe that the content of the annual reporting should be amended in accordance with the proposals outlined in question 1.

In particular:

j) for each Member State where the third-country firm provides investment services, investment activities or ancillary services, the list of investment services, investment activities and ancillary services provided by the third-country firm, together with the number of clients and total net turnover

As indicated above, it may be interesting to require firms to provide the above information by categories of clients, i.e. professional clients and eligible counterparties. MiFID II investor protection rules are calibrated in accordance with clients' level of knowledge and expertise. Additionally certain of those obligations are disapplied when dealing with eligible counterparties. To ensure a level playing field between EU firms and third-country firms it is paramount that both comply with the same type of standards.

k) the total number of clients and counterparties of the third-country firm globally;

Same as above: it will provide ESMA with a useful tool to carry-out risk based supervision.

m) where the third-country firm performs the activity referred to in point (3) of Section A of Annex I of MiFID II, information on the exposure of the third-country firm to counterparties in the Union, together with a breakdown of such number per Member State where the third-country firm carries out dealing on own account;

It should be specified that this applies also to firms dealing on match-principal-basis. We understand that EU firms are well aware of Recital 24 of MiFID II, but it may not be the case for third-countries firms.

p) where the third-country firm provides the service referred to in point (5) of Section A of Annex I to Directive 2014/65/EU, information about the value of the assets in relation to which that service has been provided, together with a breakdown of such number per Member State where the third-country firm provides investment advice

The information to be collected in relation to investment advice should reflect upon MiFID II framework, i.e. whether the firm provides investment advice on independent basis or not, whether it receives or pay any monetary and/or non-monetary benefits and whether and how it is disclosed to their clients.

q) where the third-country firm provides the ancillary service referred to in point (1) of Section B of Annex I of MiFID II or is holding client funds, information on the value of the assets (including cash) held by the third-country firm for clients in the Union, together with a breakdown of such number per Member State where the third-country firm provides investment advice;

We believe that there is a typo at the end of this paragraph: "investment advice" should be replaced by "safekeeping and administration of financial instruments"

Q3: Do you have any comments about the format details provided in the draft implementing technical standards under Article 46(8) of MiFIR? If no, what would you add, delete or amend and for which reasons? Please provide detailed answers.

Annex I

Section 1 & 2: Please see answers in question 1: a) and b)

Section 3, 5: Please note that not all NCAs have an electronic register. Firms should be able to provide alternative proof of registration/authorisation

Section 7, 2-3-4: The wording needs to be clarified. The address of the domicile is not requested and then a postal address is requested when different from the address of the domicile: it is quite confusing.
If the outcome sought is to obtain 1. a confirmation that the members of the managing body reside in the country where the firm is registered and supervised and 2. an address of correspondence then this shall be amended accordingly. Indeed, requesting the address of the domicile of managing body's members is uncommon except maybe for AML/CFT reasons and not very useful neither as professional correspondence should be sent to the place of work.

Section 8, 2-3-4: same as above

Section 9, 2-3-4: same as above

Section 13, 1: Suitability requirements apply to retail, elective professional and professional clients only. Provided that under the Third Country access rules, services can only be provided to professional clients and eligible counterparties, the wording need to be clarified to understand what is meant by "the categories of clients for whom such assessment applies"

Section 14: No information is required to ensure that clients receive information on the firm order execution policy in good time before the provision of the service, nor any information is collected to ensure that clients are provided on annual basis with information similar to the information included within RTS 28. This is creating an uneven playing field between third countries firms and EU firms together with jeopardising investors' protection framework.

Annex II

Please see answers to question 1 and 2.

Section 11, 3: What is the most important is not the number of staff but whether that staff is appropriately trained and qualified to monitor EU operations (e.g. fit & proper test). For instance the rules in the USA on conflict of interests and/or IPO allocation are very different from the one implemented within the EU: in the USA, disclosures are a recognised mean of management, under MiFID II disclosures cannot be used as such.

Section 12, 3: see section 11, 3.

Section 15.4: see answer in question 2, j)

Section 16: see above

Section 18 to 22: In those sections details are requested for investment activities/services 3 to 5 of Annex I, section A and 1 of Section B, none are requested for activities 1 and 2 or other ancillary services such as 4 for instance. Whilst

we understand that ESMA wishes to have statistics in relation to certain of those investment activities/services such as PM or Dealing on own account as it may have a direct impact on investors protection and/or orderly market functioning, collecting information of investment advice seems excessive. Indeed, services provided under third country access framework are provided to professional clients and eligible counterparties: those categories of clients are knowledgeable and have sufficient expertise and experience to understand the risks linked to given financial instruments and/or products and therefore it is not extremely relevant for ESMA from a risk perspective to monitor that information.
On the other hand, no specific information is requested on services 2 & 3 of the Annex I, section A whilst those are the bulk of the activities that historically take place on cross-border basis. When provided with investment advice a client may choose or not to follow the advice and/or have the transaction executed with the counterparty providing the advice, for service 1 & 2 clients are more vulnerable as they depend on the firm order execution arrangements to obtain the best possible results.

We propose to add an additional section that will cover investment services 1&2 of the Annex I, section A and to replace the information on volume and turnover collected under section 21 with information on inducements & conflict management (see question 2, p))

Q4: Do you agree with the additional details provided in the draft implementing technical standards under Article 41(5) of MiFID II? If no, what would you add, delete or amend and for which reasons? Please provide detailed answers.

The level and nature of details to be provided under Article 41(5) is similar to the contents listed in RTS & ITS stemming from Article 46 and therefore we believe that the proposal put forward above should apply where relevant.

Q6: Are there any additional comments that you would like to raise and/or information that you would like to provide?

We believe it is important to verify that where third country firms access the Union market they do so on an even playing field with EU firms, i.e. they have to comply with the same type of rules that EU firms do to foster healthy competition, ensure appropriate level of investor protection and orderly functioning of the markets.