A response to ESMA's consultation paper ESMA35-43-2131 on

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

23 April 2020

Introduction

UK Finance is pleased to respond to ESMA's consultation paper ESMA35-43-2131 on draft technical standards on the provision of investment services and activities in the European Union by third-country firms under MiFID II and MiFIR.[1] The consultation is primarily of interest to third-country firms providing investment services and activities in the European Union either (i) on a cross-border basis according to the national law of their host Member State or (ii) though a branch. Subject to any extension of the transition period, the United Kingdom (UK) becomes a third-country of the European Union (EU) on 1 January 2021. Accordingly, this consultation affects members of UK Finance that provide investment services into the EU.

UK Finance has reviewed the consultation paper from two points of view: first, with regard to the impact of the proposal on the EU MiFID framework in general; and second, from the perspective of third-country firms wishing to make use of the equivalence regime, which will include many UK Finance members. UK Finance and its members appreciate the clarity provided by setting out in detail the information required to be provided in an initial application and on an ongoing basis. We have some concerns however, set out below, as to the extent of the information required to be provided by the draft technical standards (RTS).

UK Finance is the collective voice for the banking and finance industry. Representing more than 250 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

General approach

Before responding to the individual questions raised in the consultation paper, we wish to make some observations on the general approach taken in the consultation paper in determining the scope of the information that is required to be provided.

[1] https://www.esma.europa.eu/press-news/consultations/draft-technical-standards-provision-investment-services-and-activities-in; https://www.esma.europa.eu/sites/default/files/library/esma35-43-2131_cp_on_provision_of_services_by_tcfs.pdf

Assessment of information by reference to ESMA's functions and powers

In determining the scope of information that should be provided, we consider that it is appropriate to have regard to the functions and powers that ESMA (and EU competent authorities) have in relation to third-country firms' initial application for registration and the ongoing monitoring and supervision of those firms once registered. ESMA should only require firms to provide information that it or the competent authorities need to perform those functions and exercise those powers.

ESMA recognises in the consultation[2] that it has relatively limited powers in relation to the initial application. ESMA justifies the information requested by reference to its "increased responsibilities" under the third-country regime following the changes made by Regulation (EU) 2019/ 2033 of the European Parliament and of the Council (IFR), and also on the basis that the information should be aligned with the information required to be provided by registered third-country firms on an annual basis as a result of the IFR amendments.

We set out in the Annex a description of ESMA's functions and powers in respect of the initial application for registration and on an ongoing basis thereafter. In summary, in relation to the application, ESMA is required to ascertain that the scope of the firm's authorisation is sufficient, that it has procedures to meet its annual reporting obligation and that it is subject to effective supervision and enforcement. If those conditions are fulfilled, and an equivalence determination has been made by the European Commission, ESMA is obliged to register an applicant firm. On an ongoing basis, ESMA has the power to prohibit or restrict a firm from providing services or performing activities in certain circumstances on a temporary or permanent basis. ESMA can inspect data maintained by a firm on transactions it has entered into, it can request further information and it is envisaged that ESMA may launch investigations and on-site inspections

We do not consider that ESMA has demonstrated why it requires the information that is required by the draft RTS by reference to its functions and powers under the third-country regime. Importantly, we note that registered firms are not subject to supervision by ESMA or EU competent authorities. It is therefore not clear why that information is needed or how ESMA would make use of it in practice.

The information being requested by ESMA under the proposed RTS is more suitable for a situation where a competent authority is assessing whether to grant full authorisation to a firm and for assessing a firm's compliance with the regulatory obligations applicable to it. This contrasts to the more limited functions and powers which have been granted to ESMA under the MiFIR Level One text, as amended by the IFR, in respect of the registration of third-country firms. Furthermore, we would expect that if ESMA had a concern, it would be more appropriate and effective to raise this with the firm's home regulator in the first instance, given that the home regulator will have more in-depth knowledge about the firm's operations and will be able to respond to specific queries.

We set out below, in answer to questions One and Two, particular instances where the information required seems disproportionate to the nature of ESMA's functions and powers.

Consistency with MiFID framework and objectives

An application for registration may only be approved after the European Commission has made a finding of equivalence under Article 47 of MiFIR in relation to the legal and supervisory arrangements of the third-country where the applicant is authorised. ESMA's function at the registration stage is not to carry out a further assessment of the adequacy of the third-country's arrangements by reference to the way in which the firm complies with those arrangements. The draft RTS requires

[2] Paragraph 9 of section 3.

granular information to be provided about the way in which firms achieve selected regulatory outcomes (such as the suitability of investment advice or best execution). This is potentially inconsistent with the equivalence assessment made by the Commission, which may regard regulatory outcomes as being achieved in a different way. It also implies that ESMA is seeking to taking its own view as to the equivalence of the third-country's regime by testing the way in which the regime applies to individual firms.

We are also concerned that the effect of the large volume of information required at the application stage could be to convert what is intended under the MiFID framework to be a relatively routine registration process into something more akin to an authorisation process. This would frustrate the objective of the third-country regime, which is to grant EU professional clients and eligible counterparties access to financial services provided from a third-country, with an appropriate level of protection (as is recognised in the cost-benefit analysis included in the consultation paper). It would be contrary to the interests of EU clients to restrict their access to firms authorised in third countries which have been deemed to have equivalent rules to the EU.

Consultation question one: *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.*

Consultation question two: *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.*

UK Finance response to questions one and two:

UK Finance answers questions one and two together since the comments apply to both the information to be provided on an initial application and in the annual report. Our comments are grouped into certain themes, set out below.

Granularity of data: In the proposed RTS, information is frequently required to be provided at a level of granularity that seems disproportionate to the functions and powers of ESMA and EU competent authorities. In relation to investor protection, extremely granular information is required, including, for example, a detailed description of the suitability assessment process, a specification of execution venues for each class of financial instruments and information on the name of any custodian used to safeguard client funds and related contracts.

We acknowledge that it is important that EU investors should be adequately protected when dealing with third country firms. However, as recognised in Recital 47 of the IFR, ensuring investor protection and the integrity and stability of financial markets in the Union is addressed as part of the process of determining if the third country has equivalent rules to the EU. Therefore, given that an equivalence assessment of the third-country's investor protection regime will already have been carried out by the point of registration, information at the level of granularity proposed by ESMA seems duplicative of the equivalence assessment and disproportionate.

Granular information requests may also result in a misleading picture. Questions asking for the headcount in the compliance function in charge of EU operations might not, for example, take into account the fact that firms may have different organisational structures (e.g. alignment by desk, product or region). ESMA may obtain more practical information if it were simply to request a general description of how the firms' compliance function oversees EU activity rather than a numerical count. Detailed information is requested in respect of the complaints procedure, including as to the languages in which complaints must be made: again, this seems disproportionate in view of the fact that ESMA is not empowered to assess the adequacy of the relevant complaints procedure. Information is required to be provided as to the languages proposed to be used for types of clients and activity. Information at this level of granularity is unlikely to be maintained (and in any case seems of dubious relevance where a firm is only dealing with professional clients and eligible counterparties). We also note that ESMA and EU NCAs already have access to a significant amount of data in the EU from EU firms' transaction reports, which will identify transactions that involve third-country firms.

Provision of information on a per Member State basis: although the annual information requirements in Article 46 of MiFIR, as amended by the IFR (Level One) require information as to the scale and scope of the services and activities carried out by the firm in the EU to include the geographical distribution across Member States, the very detailed information required to be provided on a per-Member State basis does not seem proportionate. The relevant information includes information on expected (in respect of the initial application) and actual (in respect of the annual report) number of clients and net turnover, information on monthly counterparty exposures in respect of own account dealing and underwriting and on the value of assets in respect of which the service is provided in respect of portfolio management, investment advice and safekeeping and administration. On the basis that enforcement powers are granted to ESMA rather than EU competent authorities, it is unclear why such granular information is required to be provided on a Member State basis. It is likely to be a significant burden for third-country firms to obtain and prepare this information. It would seem more proportionate for less detailed information (for example, on annual net turnover) to be provided on a per-Member State basis and for ESMA then to rely on its power to request further information if necessary this indicated unusual concentrations of activity in a particular Member State.

Activities outside the EU: information is sought in certain cases about the activities of firms outside the EU and it is unclear how this is relevant to performance of ESMA's functions or the exercise of its powers. Information is required as to how activities in the EU will contribute to the strategy of the firm or the group: it is not clear how the strategy of the firm outside the EU is relevant. Information is required in relation to (i) outsourcing, (ii) arrangements (including IT arrangements) for algorithmic trading, high frequency trading and direct electronic access[3], (iii) the compliance function, internal audit and the risk management function, without any express geographical limitation: it should be made clear that the information required is limited to these functions as they relate to activities carried on in the EU. Information is also required on board members and other members who effectively direct the business, who may have no involvement in business carried on in the EU.

Meaning of "Third-Country Firm": the meaning of "third-country firm" is not clear. For example, in the context of a group structure that relies on multiple third-country branches, would all of these branches be considered part of the "third-country firm" for the purposes of the information requirements, including even the non-EEA branches? We do not believe it is the intention to adopt such a wide definition as this would significantly increase the scope of information required and the compliance burden on firms, particularly given the highly granular nature of some of the requirements.

[3] We note that whilst this information is listed in article 1(k) of the draft RTS it does not appear to be reflected in the table at Annex I.

Introducing an overly wide scope would also potentially capture information which is irrelevant to the third-country firm's operations in the EU. We think that a sensible definition of "third-country firm" for the purposes of scoping the information requirements would be the parts of the firm that are materially connected to the provision of services in the EU.

Meaning of "National Competent Authority": information is required to be provided in relation to the third-country firm's national competent authority. Although the meaning of a national competent authority is well established in relation to EU authorised firms, it is less clear for firms authorised in some third countries. A third-country firm could be subject to regulatory oversight from many regulators but all of them will not necessarily be relevant for the purposes of an application for registration. Furthermore, it is not clear whether self-regulatory organisations are considered competent authorities for this purpose. We should be grateful for clarification as to which regulatory authorities need to be identified. We suggest that this should be limited to the principal regulator in the location of the head office of the third county firm.

Information outside the scope of the Level One requirements for annual reporting: In certain respects the information required for both annual reporting and the initial application (which ESMA states in the consultation paper should be aligned with the annual information[4]) goes beyond the scope envisaged by the Level One requirements. The following information that is required does not fall within any of the categories set out in Level One: information as to how activities in the EU will contribute to the strategy of the firm or the group; information on the compliance and internal audit functions; information on the firm's planned marketing strategy and the languages proposed to be used with clients in the EU; information on any investor compensation scheme and whether EU clients will be eligible; and information on the arrangements for algorithmic trading, high frequency trading and direct electronic access. If the legislature considered that this information was required, then it was free to include it. The fact that this information falls outside the categories in Level One clearly demonstrates that the information was not considered necessary and reflects an overreach on the part of ESMA. In relation to annual reports, similar detailed information specific to investment services and activities other than dealing on own account and underwriting, which are specifically identified in Level One, is required: these include portfolio management, investment advice and safekeeping and administration. Information on governance arrangements is only required by Level One "for the activities of the third-country firm in the Union, whereas information is required to be provided in respect of board members and key function holders generally". In relation to information about the firm's planned marketing strategy, we do not understand why this information is being requested, nor do we think the reference to marketing (without additional detail) is sufficiently clear.

Information on anticipated levels of activity: this is required in certain instances at the application stage but may be difficult to assess with any accuracy. Information is requested on expected number of clients and net turnover per Member State. In addition, we note that the number of clients and counterparties may not adequately take into account the multi-jurisdictional nexus of clients and counterparties with their legal entities entering into the relationships. For example, the contractual relationship may be with the fund located outside the EEA, managed by an asset manager located inside the EEA but with all investment dialog may be with a dealing desk appointed by the asset manager that is outside the EEA.

Description of policies and procedures for compliance with investor protection requirements: it is not clear how the detailed information that is required on policies and procedures for compliance with investor protection requirements will assist ESMA or EU competent authorities in performing their functions or exercising their powers. The adequacy of the investor protection measures applicable

[4] Paragraph 9 of section 3.

to the firm will already have been assessed in the Commission's equivalence assessment and neither ESMA nor the EU competent authorities are empowered to challenge that assessment. It is unlikely to be possible for ESMA to assess the firm's actual compliance with the investor protection measures applicable to it from information provided as to compliance policies and procedures, since neither ESMA nor the competent authorities are supervisory authorities in respect of those measures and they will not be familiar with them. It would also not be appropriate for ESMA to assess whether the steps taken by the firm are equivalent to those required by EU investor protection measures, since Member States are specifically prohibited from imposing additional requirements on a registered firm.[5] It would be more appropriate for firms simply to confirm that they have arrangements in place in the relevant areas.

Material changes: where the subject matter of information required to be included in annual reports is the same as that of information required to be provided at the time of application, only changes to that information need to be provided. Article 2 of the draft RTS generally requires only a "material change" to be reported. It would be helpful for some guidance to be provided as to what constitutes a material change. Article 2(1)(g), in relation to governance arrangements, should also refer to material changes rather than "any change".

***Consultation question three**: 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.*

UK Finance response to question three:

UK Finance has no comments on format details. In respect of the information sought, see our comments above under "General approach".

***Consultation Question four:** 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.*

UK Finance response to question four:

UK Finance does not have any comments on the proposed information requirements themselves. We note, however, that the information to be provided under Article 41(5) of MiFID II relates to branches of third-country firms authorised in a Member State. ESMA states in the consultation paper that, as the list of information to be provided by the branch of a third-country firm under Article 41(3) of MiFID II, as amended by the IFR, is highly similar to the list of information to be provided by third-country firms under Article 46(6a) of MiFIR, the draft technical standards relating to both sets of information should be aligned as much as possible.[6] However, in the former case, the branch is authorised and supervised by the relevant EU competent authority and is required to comply with

[5] Article 46(3) MiFIR.

[6] Paragraph 23 of section 4.

obligations under MiFID II and MiFIR whereas, in the latter case, ESMA only has the limited registration and intervention powers described above and the firm is not obliged to comply with substantive EU rules. This indicates more limited information is appropriate in the latter case than in the former.

Consultation question five: *Do you agree with the cost benefit analysis as it has been described in Annex II?*

UK Finance response to question five:

In relation to the benefits of the draft RTS identified in the cost-benefit analysis, UK Finance acknowledges that providing certainty to third-country firms seeking to register with ESMA is beneficial. We do however disagree with ESMA's assessment in two key respects:

Firstly, regarding 'benefits', UK Finance does not agree that third-country firms will no longer have to "monitor national third-country regimes" once the new regime is in place. If equivalence is removed (or if there is any realistic prospect of this occurring), third-country firms will need to continue to monitor national regimes as potential fallbacks. In addition, since many EU national competent authorities at present make very limited requests of third-country firms that wish to provide cross border activities, harmonising around ESMA's highly granular approach to the information requested will necessarily mean that third-country firms' costs are increased substantially.

Secondly, on 'costs', ESMA states that whilst firms may face potential and incremental costs when implementing the draft Article 46 RTS and implementing technical standards (ITS), these drafts provide the most cost-efficient solution to achieving its general objectives, and that these are the minimum information requirements necessary for ESMA to fulfil its new responsibilities. UK Finance does not agree with this assessment; as noted in the main body of this response UK Finance submits that ESMA's excessively broad and granular approach is not cost-efficient, and exceeds what is necessary for ESMA to meet its minimum obligations stemming from the Level One text.

UK Finance therefore suggests that ESMA should carry out a more detailed analysis as to how the collection of the relevant information will enable ESMA to "fulfil the new responsibilities assigned to it by the IFD and IFR[7]", on the basis indicated under "General approach" above.

Consultation question six*: Are there any additional comments that you would like to raise and/or information that you would like to provide?*

UK Finance response to question six:

See above under "General approach".

Responsible Executive

✉ yvonne.deane@ukfinance.org.uk ☎ +44 (0) 203 934 1122

[7] Paragraph 14(g) of Annex II.

Annex

Application for registration

Under Article 46 of MiFIR, as amended by the IFR[8], following an equivalence determination in relation to a third-country with which co-operation arrangements are in place, ESMA is required to register an applicant from that country provided that (i) the firm is authorised to provide the investment services and activities to be provided in the EU and is subject to effective supervision and enforcement ensuring full compliance with the third-country's regime; and (ii) the firm has established arrangements and procedures to meet its annual reporting obligation.[9]

Following registration

Once a firm is registered, Member States are not permitted to impose additional requirements on it.[10] Registered firms are not subject to supervision in the EU, and they must inform clients that that is the case.[11] Nevertheless, ESMA and EU competent authorities do have certain specific powers in relation to third-country firms. ESMA or EU competent authorities can require a firm to provide further information.[12] Firms must keep data relating to all orders and transactions in the EU at the disposal of ESMA and ESMA, at the request of an EU competent authority, can access that data.[13] ESMA may temporarily prohibit or restrict a firm from providing services or performing activities where it has failed to comply with any product ban imposed by ESMA or a competent authority or any request to provide further information or access data made by ESMA or does not co-operate with an investigation or an on-site inspection.[14] ESMA may withdraw the registration of a firm, after referring the matter to the firm's competent authority, where it has well-founded reasons to believe that the firm, when providing services or activities in the EU, either (i) is acting in a manner that is clearly prejudicial to the interests of investors or the orderly functioning of markets or (ii) has seriously infringed the provisions applicable to it in the relevant third-country on the basis of which the Commission adopted its equivalence decision.

In addition, when the scale and scope of the services and activities performed by third-country firms are likely to be of systemic importance to the EU, the European Commission may attach "specific operational conditions" to equivalence decision to ensure that ESMA and national authorities have the necessary tools to ensure that firms comply with requirements having an equivalent effect to the post-trade transparency, transaction reporting and mandatory share- and OTC derivatives-trading obligations under MiFIR. The criteria specified for equivalence assessments also assume that ESMA and EU competent authorities will have the ability to carry out investigations and on-site inspections where necessary for the accomplishment of their tasks under MiFIR.[15]

---

[8] All references to MiFIR are as amended by the IFR.

[9] Article 46(2) and 46(4) MiFIR.

[10] Article 46(3) MiFIR.

[11] Article 46(5) MiFIR.

[12] Article 46(6a) MiFIR.

[13] Article 46(6b) MiFIR.

[14] Article 49(1) MiFIR.

[15] Article 46(6(c)) MiFIR.