SOME EXAMPLES: (1) LACK OF COORDINATION AND INTERACTION AMONG REGULATIONS

Interactions of individual rules.-

(i) Different Definitions:

- **Market maker/market making activities.-** There are various pieces of legislation which include non-homogeneous definitions of market maker or market making activities. For instance this is the case of article 4.2(7) of MIFID 2 and article 1.1.(k) of Regulation 236/2012 on short selling and certain aspects of credit default swaps. In fact, Recital 60 of MIFID 2 expressly states that the definition of market making activity "*is therefore independent from definitions such as that of 'market making activities' in Regulation (EU) No 236/2012 of the European Parliament and of the Council*". The existence of different concepts of market making across the different European regulations gives rise to legal uncertainty and may led to practical problems.

- **Liquid instruments/markets.-** MIFID 2/MIFIR and the proposed level 2 rules include a definition of liquidity/liquid markets which is relevant for the purpose of transparency (transparency obligations are modulated depending on the liquidity of the instrument). In addition, the Consultation Paper on PRIIPs published on 11 November 2015[1] determines when an instrument is illiquid for the purpose of including certain warnings in the Key Investment Document. The concept included in this Consultation Paper has nothing to do with the liquidity concept foreseen in MIFID 2/MIFIR. Different concepts of liquidity increase complexity in the financial markets.

(ii) Overlaps, duplications and inconsistencies:

- **PRIIPs vs. MIFID II:** Both PRIIPs and MIFID II contain pre-contractual disclosure requirements when dealing with retail clients, specifically regarding risks and costs. Although these regulations do not cover exactly the same scope there will be a broad range of products that will be subject to both rules. In this context, investment firms should be able to rely on the PRIIPs Regulation to comply with MIFID requirements.

  In addition, for the sake of legal certainty, we believe that it would be helpful to include in the KID a specific reference to the fact that the KID satisfies MIFID pre-trade transparency obligations of the product manufacturer, so as to avoid unnecessary duplication of documentation. We contend that duplication of these disclosure requirements would be detrimental both for investment firms (due to the consequent increased operational burden and administrative costs) and for clients (where excessive and duplicative documentation could detract from the effectiveness of such communications and lead clients to lose sight of what is important). An effort should be made to align the information requirements for both regulations as much as possible to avoid documentation overload being suffered by clients.

- **Overlap of EMIR, MiFID 2, MiFIR and SFT Regulation regarding reporting requirements:** Reporting obligations have been implemented by a number of EU legislative

[1] https://www.eba.europa.eu/documents/10180/1268855/JC+2015+073+CP+PRIIPs+Key+Information+Documents.pdf

acts towards different regulatory bodies, which result in firms reporting the same information more than once. Greater co-ordination between legislative initiatives is required to avoid firms incurring unnecessary costs and resources to comply with repeated obligation. Art 71 of BRRD implements reporting requirements that are very similar to those required by EMIR, MiFID 2/MiFIR, MMRS and SFT Regulation. Such duplicative obligations result in onerous and unnecessary obligations on banks that will hinder their essential role as catalysts of the capital markets union. To solve this problem, reporting obligations under EU legislation should be harmonised (regarding data to be reported, technology to be used, ways of completing relevant data, requiring and allowing counterparties to develop the best way to report directly to the NCA or using the services of a third party) and in certain cases it could be centralized in one central repository which would manage and consolidate the data requirements of firms. The trade repositories established by EMIR/SFTR could be the relevant entity to take this role, given that this is their exclusive purpose, but having different entities receiving the data does not justify data reporting duplication.

- **PRIIPs vs. Prospectus Directive:** whilst the Prospectus Directive is not applicable to all PRIIPs, it will be applicable to a significant range of such products. We note that delineation between the purposes of the two regulations would reinforce the purpose of the KID as a tool for investors to compare PRIIPS and satisfy MIFID pre-trade transparency obligations, but not as the document on which investors should make investment decisions, especially where a prospectus has been issued. As such, where appropriate it would be helpful for investors to be directed to the relevant Prospectus Directive documentation from the KID.

  We also note that different approaches are taken to the disclosure risks under PRIIPS and under the Prospectus Directive – we are concerned that information that is required in the KID is not required under the Prospectus Directive and vice versa and formal guidance in this regard concerning this and any other areas of overlap would increase confidence in the market. In addition, where products are being offered subject to the disclosure requirements of the Prospectus Directive or in relation to product issuers that are subject to continuing obligations (e.g. under product issuance programs), any 'significant' changes are required to be notified to the market. It is not clear to what extent such a test would dovetail with the requirement under PRIIPS to review and republish a KID. In order to increase the efficiency of the market the ability for the review or supplement of a single document to satisfy the disclosure requirements of both regimes should be considered where possible.

SOME EXAMPLES: (2A) Level 2 Rules /Q&A

A) Timing

- **PRIIPs status:** The European Supervisory Authorities (ESMA, EBA, EIOPA) issued its proposal for regulatory technical standards (RTS) on Key Information Documents (KIDS) for packaged retail and insurance-based investment products on 07/04/2016. The draft RTS have now been submitted to the European Commission (EC) which has three months to decide to endorse the text or amend. After endorsement by the EC, the text will be sent to both the European Parliament and Council for formal approval. The obligations under PRIIPs regulation enter into force on 01/01/2017.

- **MIFID 2 status:** Both MIFID 2 and MIFIR were to become applicable as of 3 January 2017, with member states having to transpose the new directive by 3 July 2016. However, due to technical implementing challenges faced by the European Securities and Markets Authority

(ESMA) and by national competent authorities, a delay of one year was proposed. On 18 May 2016, the Permanent Representatives Committee (Coreper) approved, on behalf of the Council, an agreement with the European Parliament on a one-year delay to new securities market rules. However, the regulation enacting the extension has not been adopted yet.

Under the approach agreed with the European Parliament: the deadline for the member states to transpose MIFID II into national legislation will be set for 3 July 2017; the date of application of both MIFID II and MIFIR will be set for 3 January 2018.

(B) Some examples of Level 2 rules that go beyond Level 1: MIFID 2

- **Recordkeeping**

Paragraph 10: Article 16.7 of MIFID 2 states that "*Orders may be placed by clients through other channels, however such communications must be made in a durable medium such as mails, faxes, emails or documentation of client orders made at meetings. In particular, the content of relevant face-to-face conversations with a client* ***may be recorded*** *by using written minutes or notes. Such orders shall be considered equivalent to orders received by telephone*". In short, the Level 1 rules recognize the possibility (but not the obligation): **(i)** to receive client orders at meetings; and **(ii)** to produce written minutes to document meetings with clients whenever such meetings result in the placement of an order.

However, ESMA's TA goes well beyond Level 1 by establishing the obligation (rather than the possibility) to document all relevant meetings with clients. In particular, the proposed Level 2 rules state that "*Investment firms* ***shall*** *record in a durable medium all relevant information related to relevant face-to-face conversations with clients*". Therefore, there is no legal empowerment to impose the aforementioned obligation and the delegated acts should not follow the TA in this respect and should be consistent with the Level 1 rules. Accordingly, the Commission's delegated acts should foresee the possibility to document meetings with clients when these result in the placement of an order, but should not specify this as an obligation.

In addition, as per Article 16.7 of MIFID 2, the recording of written minutes documenting meetings with clients only applies whenever such meetings result in the placement of an order. In view of paragraph 17 of ESMA's analysis following the feedback from stakeholders we understand that this is the idea behind the draft TA; however, the fact that the TA makes reference to "**relevant** face-to-face conversations" and that it uses the plural form when specifying the information to be recorded during such conversations (date and time of **meetings**, location of **meetings**, etc.) could lead to the idea that the recording of written minutes applies to almost any meeting with clients where a potential transaction (whether it is finally concluded or not) is discussed. This would contravene the Level 1 rules so, if a minimum content is specified for those records for such cases in which firms decide to document meetings, clarification in this regard would be appreciated.

- **Product governance:**

Article 16.3 of MIFID 2 stipulates that:

"*3. An investment firm shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to*

prevent conflicts of interest as defined in Article 23 from adversely affecting the interests of its clients.

An investment firm which manufactures financial instruments for sale to clients shall maintain, operate and review a process for the approval of each financial instrument and significant adaptations of existing financial instruments before it is marketed or distributed to clients.

The product approval process shall specify an identified target market of end clients *within the relevant category of clients for each financial instrument and shall ensure that all relevant risks to such identified target market are assessed and that the intended distribution strategy is consistent with the identified target market. An investment firm shall also regularly review financial instruments it offers or markets, taking into account any event that could materially affect the potential risk to the identified target market, to assess at least whether the financial instrument remains consistent with the needs of the identified target market and whether the intended distribution strategy remains appropriate.*

An investment firm which manufactures financial instruments shall make available to any distributor all appropriate information on the financial instrument and the product approval process, including the identified target market of the financial instrument. *Where an investment firm offers or recommends financial instruments which it does not manufacture, it shall have in place adequate arrangements to obtain the information referred to in the fifth subparagraph and to understand the characteristics and identified target market of each financial instrument.*

The policies, processes and arrangements referred to in this paragraph shall be without prejudice to all other requirements under this Directive and Regulation (EU) No 600/2014, including those relating to disclosure, suitability or appropriateness, identification and management of conflicts of interests, and inducements."

The last draft of the Commission Delegated Directive stipulates in Article 10 (Product governance obligations for distributors):

"2. Member States shall require investment firms to have in place adequate product governance arrangements to ensure that products and services they intend to offer or recommend are compatible with the needs, characteristics, and objectives of an identified target market and that the intended distribution strategy is consistent with the identified target market.

Investment firms shall appropriately identify and assess the circumstances and needs of the clients they intend to focus on, so as to ensure that clients' interests are not compromised as a result of commercial or funding pressures. As part of this process, firms shall identify any groups of clients for whose needs, characteristics and objectives the product or service is not compatible*.*

Member States shall ensure that investment firms obtain from manufactures that are subject to Directive 2014/65/EU information to gain the necessary understanding and knowledge of the products they intend to recommend or sell in order to ensure that these products will be distributed in accordance with the needs, characteristics and objectives of the identified target market,

Member States shall require investment firms to take all reasonable steps to ensure they also obtain adequate and reliable information from manufacturers not subject to Directive 2014/65/EU to ensure that products will be distributed in accordance with the characteristics, objectives and needs of the target market. Where relevant information is not publicly available, the distributor shall take all reasonable steps to obtain such relevant information from the manufacturer or its agent. Acceptable publicly available information is information which is clear, reliable and produced to meet regulatory requirements, such as disclosure requirements under Directive 2003/71/EC or Directive 2004/109/EC. This obligation is relevant for products sold on primary and secondary markets and shall apply in a proportionate manner, depending on the degree to which publicly available information is obtainable and the complexity of the product.

Investment firms shall use the information obtained from manufacturers and information on their own clients to identify the target market and distribution strategy*. When an investment firm acts both as a manufacturer and a distributor, only one target market assessment shall be required."*

In addition, in this respect, **Marcus Ferber (Rapporteur-European Parliament)** has affirmed that: "*Level I is quite clear that the issuer of a product defines the target market and the distributor takes it into consideration. The delegated directive however goes beyond that implying an additional target market definition made by the distributor. The Commission should clarify if this is really meant by the delegated directive and if so what would be the justification for such second target market analysis*".

SOME EXAMPLES (3) UNCOORDINATED LOCAL RULES

- **National regulation on pre-trade information:** European national authorities have, in recent years, established their own differing disclosure regimes that would now be also addressed by the PRIIPs Regulation. In particular, legislation requiring investment firms to provide its retail clients and potential retail clients with a type of uniform label indicating the risk level of each particular product has been introduced in some Member States. However, these local risk indicators are based on different criteria (risk return and costs; possibility of capital loss; market, credit and currency risk, etc.).

- **The Spanish case requiring handwritten representations:** Since August 12, 2013 some handwritten statements have to be completed by retail investors when purchasing any financial instrument (i.e.: "this is a complex product and it is considered not appropriate for me", or "I have not received advise in this transaction"…). If a product is acquired by electronic means, the investor has to type the referred legends otherwise required to be handwritten.

- **Definition of financial instrument - FX forwards:** Under MiFID 1 national authorities adopted different approaches regarding FX forwards concluded for commercial purposes. While some national authorities considered them to be a financial instrument, some others did not. This situation lead to an unleveled playing field across the Union and, recently, to certain inconsistencies in connection with EMIR reporting obligation. ESMA highlighted this situation in the recent past and, following that, the European Commission decided to unify the situation of these FX products. However, the current draft of MiFID 2 Delegated Regulation includes a wording that, far from clarifying the status of FX forwards concluded for commercial purposes, has created more doubts and controversies across market participants. In particular, paragraph 1 of Article 10 (*Characteristics of other derivative contracts relating to currencies*) currently reads as follows:

  "For the purposes of Section C (4) of Annex I to Directive 2014/65/EC, other derivative contracts relating to a currency shall not be a financial instrument where the contract is one of the following:

  (a) a spot contract within the meaning of paragraph 2 of this Article,

  (b) a means of payment that:

  (i) must be settled physically otherwise than by reason of a default or other termination event;

  (ii) is entered into by at least a person which is not a financial counterparty within the meaning of Article 2(8) of Regulation (EU) No. 648/2012 of the European Parliament and of the Council 19;

  (iii) is entered into in order to facilitate payment for identifiable goods, services or direct investment; and

  (iv) is not traded on a trading venue."