HM Treasury Consultation on the Transposition of the Markets in Financial Instruments Directive II
18 June 2015

London Stock Exchange Group

LSEG Response to HM Treasury consultation on the Transposition of the Markets in Financial Instruments Directive II

Background Information

The London Stock Exchange Group plc (LSEG) is a financial market infrastructure provider, headquartered in London, with significant operations in Europe and North America. LSEG welcomes the opportunity to respond to HM Treasury's consultation on the transposition of MiFID II.

LSEG operates a range of international equity, fixed income and derivatives markets, including: London Stock Exchange; Borsa Italiana; MTS Group and Turquoise; post-trade and risk management, including Cassa di Compensa/zione e Garanzia (CC&G), the EMIR authorised CCP; Monte Titoli, the Italian CSD; and globeSettle, a new CSD based in Luxembourg; and is majority owner of the multi-asset global CCP, LCH.Clearnet Group serving major international exchanges and platforms, as well as a range of OTC markets (with EMIR authorised CCPs in France and the UK). LSEG operates the EMIR authorised trade repository UnaVista, and offers a range of real-time and reference data products, as well as access to international equity, bond and alternative asset class indices, through the leading index providers, FTSE International Ltd and Frank Russell Company.

We have responded only to those questions which relate to the business operations of LSEG and have not provided feedback on a number of issues raised in the consultation paper.

For further information contact: Martin Koder, Regulatory Strategy, LSEG (mkoder@lseg.com).

RESPONSE TO QUESTIONS

Third Countries

1) Do you agree the UK should maintain its current third country regime and not implement Article 39 MiFID II? Please explain your reasons why and supply any evidence you have to support your answer.

If you do not agree, please provide your views on:

a) what would be the likely or expected economic and non-economic consequences of implementing the MiFID II third country regime?

b) what impact would the implementation of Article 39 MiFID II have in relation to retail cross-border business currently conducted under applicable exclusions?

Please supply any evidence you have to support your answers.

LSEG supports the proposal to maintain the UK's current third country regime. Non-EEA firms trading on our markets as members or trading through our members (on LSE, Turquoise and MTS) may be negatively impacted if the "with or through" exclusion were to be amended to opt-in to the Article 39 MiFID II regime. If the ability of these firms to trade on our markets was impeded, this might have a negative impact on the liquidity of instruments traded on our markets and limit the geography of our membership.

Narrowing the UK Overseas Person exemption in a way that it will not be applicable anymore to third country firms which intend to deal, via an authorised or exempted entity (eg LSE), with retail or eligible professional clients in the UK, might create administrative burdens for prospective non EEA member firms. They might therefore decide to keep routing their business to LSE, or the other UK markets, via the local branches of the international investment banks as they currently do today, instead of opting to becoming direct members of our markets, thus losing the economic advantages of reduced intermediation trading costs and higher international exposure and reputation. UK based trading venues would also potentially lose business opportunities to offer services to firms located outside the EEA, as transacting through a UK trading venue would no longer be seen as more convenient means of market access than any other method by non EEA firms.

However, the 'opt out' approach may also imply that third country branches in the UK will not be able to benefit from the Passport rights in the EEA, even if those countries were considered as equivalent by ESMA. This issue would only actually materialise after 2020 (3 years after the entering into force of MIFID II, assuming that some countries will be declared as equivalent in 2017). It might be prudent, therefore, if HM Treasury considered reviewing its position 3 years from the implementation of MiFID II, to examine the actual use of the third country equivalence regime.

Data reporting services

2) Do you agree that it is appropriate and proportionate to create a separate regulation for DRSs and in particular not to include them as regulated activities under the RAO?

LSEG agrees that the activities undertaken by data reporting services are fundamentally different from investment activities which are covered by the general prohibition in FSMA (as further detailed in the RAO). It does not seem appropriate to include DRSs in the scope of regulated activities since the regime applicable to them under MiFID II is distinct from that applicable to investment firms offering the investment services in Section A of Annex I of MiFID II. This should be reflected in the UK implementation to keep the provision of DRSs as a separate regulatory concept from investment services.

3) Do you agree with the general approach to implementation of Title IV MiFID II including copying out the definitions in respect of CTPs, ARMs and APAs? If not please suggest an alternative, such as following the structure of 'investment firm' definition.

LSEG supports the approach of copying out the legislation for implementation where possible and understands that the definitions of CTPs, ARMs and APAs can be somewhat difficult and self-defining. However, it is not clear that alternative options would be any clearer or provide more certainty and we understand why this has led to the use of the definition of "data reporting service" as being the regulated activity in question.

In respect of the actual definitions of APAs and ARMs, they do not just provide their services to investment firms, but will also provide them to other entities, such as regulated markets.

We support the need for a harmonised, post-trade tape to allow investors to understand the quality of their execution. However, there is no real definition or description of what the Consolidated Tape should be, apart from all trades in all instruments subject to a 3 month allowance for trading on a new venue. There is nothing on the user requirements, latency or granularity of data feed that would enable the industry to develop a business model for introduction of a service in time for the ESMA review of the operation of the Consolidated Tape, which is likely to have to start in late 2017, given the deadline for the delivery of the report.

<u>Transposition of the deadline for transaction reporting under MiFIR Art 26.</u>

The obligation in MiFIR 26(1) is that "Investment firms which execute transactions in financial instruments shall report complete and accurate details of such transactions to the competent authority as quickly as possible, and no later than the close of the following working day."

In Annex B to the Consultation, in Regulation 15, HMT proposes the following language by way of transposition:

Conditions for an ARM
15.—(1) An ARM must have adequate policies and arrangements in place to provide the service to an investment firm of reporting the information required from that firm under Article 26 of the 9 markets in

financial instruments regulation as quickly as possible and no later than 5pm of the working day following the day on which the transaction took place.

For the following reasons, we suggest that this should be amended to read:

Conditions for an ARM
15.—(1) An ARM must have adequate policies and arrangements in place to provide the service to an investment firm of reporting the information required from that firm under Article 26 of the 9 markets in financial instruments regulation as quickly as possible and no later than **11.59pm** of the working day following the day on which the transaction took place.

Reasons:

Interpretation of "Working Day"

1. We suggest that the words "the close of the following working day" be given their natural meaning, namely to distinguish business days from weekends and bank holidays, where the T+1 period would extend to the next working day. There does not appear to be any policy requirement or mandate in the Level I text to interpret "the close of the following working day" to mean at the end of business or market hours; in addition, to interpret this wording in this narrow way would then not be as simple as setting a single time based on "UK typical business hours" or the LSE's market- there will be many trading venues and OTC venues where trading by parties subject to UK transaction reporting would not be confined to traditional hours, particularly across time zones.

2. In addition, EEC Regulation No.1182/71 deals with the determination of rules applicable to periods, dates and time limits (see attached). Article 3 of the Regulation states that "a period expressed in days shall start at the beginning of the first hour of the first day and shall end with the expiry of the last hour of the last day of the period."

   Article 26 of MiFIR says "no later than the close of the following working day". We suggest that this is a period expressed in days (it is certainly not a period expressed in hours, weeks, months or years), so according to the Regulation, the period would end upon the expiry of the last hour i.e 11.59pm.

Market Practice and Arrangements

3. Current MiFID I, Article 25(3), requires transactions to be reported in the same timeframe as that specified in MiFID II- "as quickly as possible, and no later than the close of the following working day".

   MiFID I Article 25(3):
   Member States shall require investment firms which execute transactions in any financial instruments admitted to trading on a regulated market to report details of such transactions to the competent authority as quickly as possible, and no later than the close of the following working day.

4. On the basis of that requirement, the systems of the FCA, ARMs and most investment firms are currently geared to ensure delivery of transaction reports to the FCA by the end of the following day (i.e. 11.59pm on T+1). Depending on the way in which the investment firms are organised, they are often not in a position to collect and assemble all the information necessary to provide the full transaction report information until after the UK market close on

T+1 (4.30pm), which would make it impossible for them to deliver the reports to the ARM for transmission to the FCA or to deliver the reports themselves to the FCA by 5pm, particularly given the concentration of the volumes of reports that would be required at this point. This problem is exacerbated for trades made on exchanges in the United States which need to be reported.

5. Under its current system arrangements and constraints, the FCA allocates the ARMs a limited number of slots at hourly points during the day, during which the ARM must deliver a batch of reports of up to a maximum of 1 million each time. We are not aware that the FCA has expanded its capacity to cope with all reports within the proposed timeline.

6. With the extension under MiFID II of the transaction reporting regime to cover all asset classes, the universe of reportable transactions is estimated conservatively to double current levels. If the FCA, ARMs and investment firms currently face challenges in receiving/reporting the current level of transaction reports by 21:45 PM (the time of UnaVista's latest possible reporting slot) on T+1, we question how many of those parties could effectively submit double the number of reports in a period that is reduced by 5 hours?

7. In addition, we suggest it is important to note that there will be significantly more report rejections from the ARMs and FCA as the non-equity instrument reporting is significantly more complex and the number of fields within a report has significantly increased. The task of correcting and re-reporting by close of business will be significantly more difficult if the close of business is brought forward to 5pm.

4) Do you consider that it is reasonable and proportionate to apply something akin to section 89 FSMA and section 90 Financial Services Act 2012 to a DRSP? If you do not consider it reasonable or proportionate please specify why.

While it is appropriate to include DRS providers within a similar scope to entities subject to rules on misleading statements and misleading impressions, it must be recognised that the DRS providers themselves do not originate the information they collect and publish, so are reliant upon the source material provided to them not being misleading. Whilst it is understood that DRS providers will have to provide systems capable of finding "omissions and obvious errors", this should be narrowly defined, so as to cover only missing information (eg security or instrument code, type of trade, etc) or where information provided does not accord with the data field in question (for example inputting a name in a field for the date). It should not, however, relate to the commercial or underlying aspects of any transaction, as the DRS provider would not be in a position to judge whether or not it is an error.

5) Do you agree with the transposition of the FCA powers in the DRRs? Do you consider that any further powers are necessary?

LSEG agrees that the FCA needs to have powers in respect of the standalone DRS regime in order to implement the provisions of Article 69 MiFID II. It does not appear necessary for the FCA to have any additional powers than those included in the draft regulation to implement the provisions of Article 69 MiFID II as applicable to DRS providers.

Position limits and reporting

6) Do you agree that the regulation adequately transposes the position limit regime established by Article 57 MiFID II?

While the powers for the FCA to set position limits themselves seem to reflect the regime in MiFID, we suggest that the regulation could provide a more useful definition of "commodity derivative" instead of reciting the MiFID II definition. The definition cited in MiFID II itself references another definition in MiFIR, which itself contains a definition and references back to MiFID II. This is a particularly clumsy and unclear means of conveying a definition which is intended to have legal certainty and could apply to persons who are not otherwise regulated financial entities, and may have difficulty in understanding what types of investments are in scope of the position limit regime. We suggest the following definition of "commodity derivative":

> "**means a derivative contract for any goods of a fungible nature that are capable of being delivered, including metals and their ores and alloys, agricultural products, and energy such as electricity**"

This definition comes from Article 2(1) of the current MiFID implementing regulation which further clarified the meaning of commodity for the purposes of MiFID. We have seen no suggestion that this conceptual definition will be altered by any Commission Delegated acts pursuant to MiFID II, so we believe it would aid clarity if this definition were used in the UK transposition. We also believe this defines the intended scope of the regime to commodities.

7) Do you agree that the amendments to the Recognition Requirement Regulations adequately transposes the position reporting and management regime established by Articles 57 and 58 MiFID II?

It does not make sense that a trading venue could be required to have powers over an actual underlying "person". A trading venue's rules can only reach as far as its participants, so the language in the suggested Section 7BA of the Recognition Requirements Regulations should reference participants and not the wider concept of "a person".

8) Do you agree that position reporting and management regime established by Articles 57 and 58 MiFID II for Investment Firms and Credit Institutions operating in trading venues be detailed in FCA Rules?

As the rules for MTFs and OTFs are in respect of their systems and controls, LSEG considers it appropriate to include such requirements in the existing FCA sourcebook as for other MTF (and soon to be OTF) systems and controls requirements.

9) Do you agree that the powers of the FCA reflect those provided for under MiFID II? In particular, in relation to Article 69(2)(p) and 69([2])(j) MiFID II.

LSEG believes that the power included in draft Regulation 9 should be sufficient for the FCA to gather information from a person about the position it holds in a contract to which position limits apply.

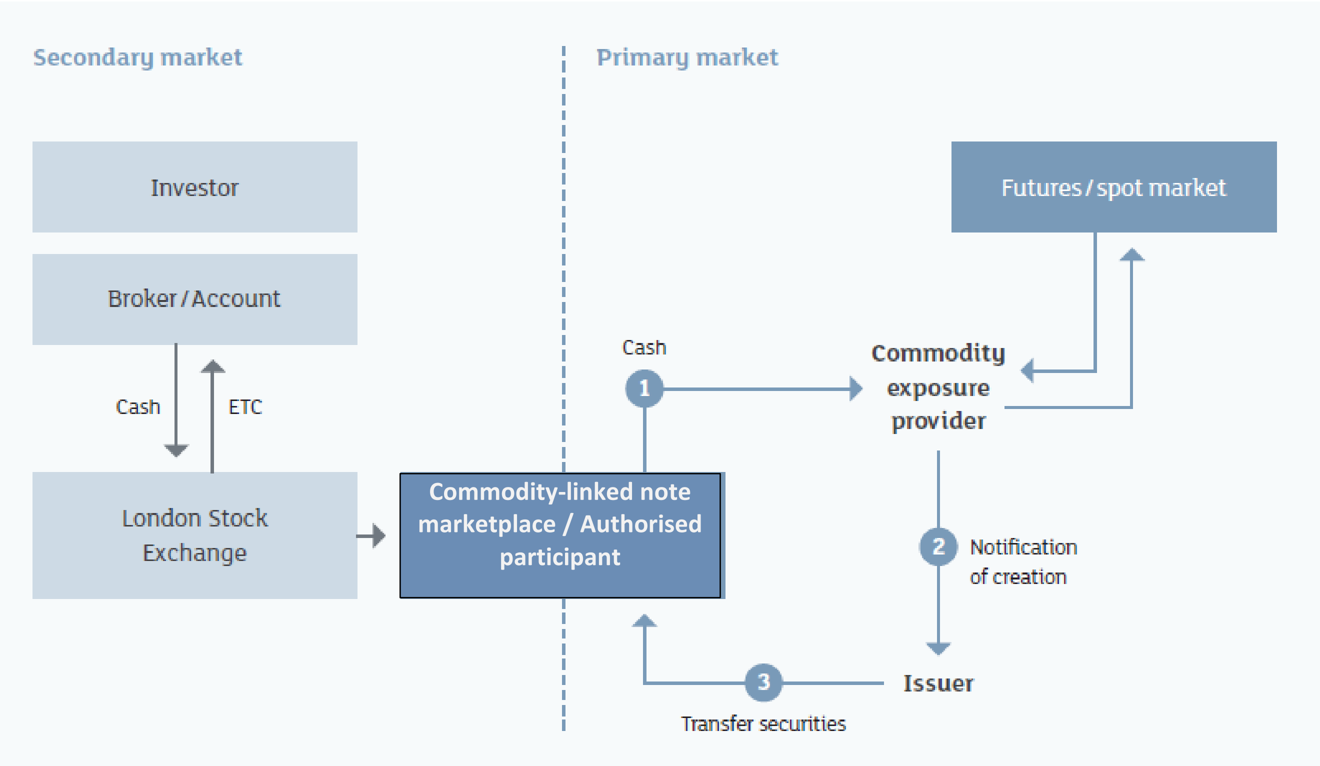
10) Do you have any further comments on the drafting of the secondary legislation in respect of the position limits and reporting regimes?

Given the point we make about scope in the response to question 6, it is important that the implementing legislation uses the correct definition so that it, and the ESMA RTS 29, only apply a position limit and reporting regime to commodity derivatives.

The commodity derivatives position limit regime is intended to target volatility in derivative contracts where buyers and sellers take equal and opposite positions on delivery of a commodity at the expiry of the contract. It should be clear from the secondary legislation that the commodity derivatives position limit regime is properly linked to the appropriate definition of commodity derivative.

An example of where there may be problems is when we consider the case of commodity-linked notes (see ESMA RTS 29(4)(2)) which have a clear division between the primary spot market and the secondary market (respectively shown in the right and left hand sides of the structure diagram below). Commodity-linked notes are different to commodity derivatives because they have multiple buyers, and just one seller (the issuer – whose responsibility it will be to report its overall position). The structure of the notes links any ability of noteholders to potentially take positions in deliverable commodities (usually in some form of redemption of notes). For this reason, they are distinct from commodity derivatives where the counterparty (as opposed to issuer) is taking a position (either long or short) but may have no means of delivery.

The nature of commodity-linked notes means that any transition from being a noteholder (with a right to receive coupon/principal) to being a counterparty to the issuer (with a right to redeem a certain amount of notes for a deliverable obligation) is not something which happens on the exchange but is a matter between the issuer and the noteholder. We believe that in RTS 29(4)(2), ESMA supports our analysis by excluding such instruments from the regime. Therefore, we suggest HM Treasury's implementation of the relevant sections of MiFID II should be consistent with this.



Creation

1a	The authorised participant (often the market maker) pays cash to the commodity exposure provider – the amount paid is based on the current creation price, set by the issuer.
1b	The commodity exposure provider then invests the money in the appropriate underlying commodity market/s.
2	The commodity exposure provider notifies the issuer that cash has been received and confirms correct amount.
3	The issuer asks Euroclear UK & Ireland Limited to create securities and transfer them into the account of the authorised participant. These securities are then available for the authorised participant to trade in the secondary market.

Redemption

Redemption is the process of creation in reverse. The authorised participant transfers securities to the issuer, who cancels them and notifies the commodity exposure provider to pay in cash the relevant amount to the authorised participant.

Unauthorised persons

11) Do you agree with the transposition drafting and approach to unauthorised persons?

It is not clear why Regulation 12 (DEA provision) has been included, as it appears to contradict MiFID II Article 48(7) which suggests that only authorised investment firms and credit institutions should be able to provide DEA to regulated markets: "Member States shall require a regulated market that permits direct electronic access to have in place effective systems procedures and arrangements to ensure that members or participants are only permitted to provide such services if they are investment firms authorised under this Directive or credit institutions authorised under Directive 2013/36/EU…". Therefore, draft Regulation 12 should be deleted.

12) Do you agree that the powers provided to the FCA in respect of unauthorised persons are appropriate in light of particular of Article 69 MiFID?

No response provided.

Structured deposits

13) Do you consider the regulated activities that have been "switched on" for structured deposits appropriate to cover the Article 1(4) MiFID II concepts of "selling or advising"? In particular, is it appropriate to treat Article 25(2) RAO and Article 37 RAO as within the meaning of "selling"?

No response provided.

14) Is the definition of structured deposits provided at Article 3 RAO clear?

No response provided.

15) Do the amendments to the FPO ensure consistency between it and the amended RAO activities in relation to structured deposits?

No response provided.

16) Do you have any further comments on the draft secondary legislation in relation to structured deposits?

No response provided.

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Power to remove board members

17) Do you consider that existing FSMA powers are sufficient for the purposes of Article 69(2)(u) MiFID? If yes, please explain how these powers do not suffer from the limitations mentioned above.

We consider that current FSMA powers would allow the FCA to direct a Recognised body to remove a director. If HM Treasury considers that may not be sufficient, including whether such removal could be sufficiently 'immediate', we agree that extending the approved persons regime would not be ideal.

18) Do you consider that FSMA powers in relation to market operators have to be amended either under Option A or B?

We agree with HM Treasury that it is likely that relying on existing powers under FSMA could create a gap in the scope of all persons to whom MiFID II provisions should apply. Therefore, to ensure proper implementation, even Option A would require amendments to be made to primary legislation.

Option B, in creating a new standalone regime, would certainly require amendments to FSMA, as HM Treasury has already suggested.

19) Do you consider that Option B is appropriate to transpose Article 69(2)(u) MiFID? If not, please specify what your preferred alternative option is and how this meets Article 69(2)(u) of MiFID.

Option B is appropriate for transposing Article 69(2)(u) and is our preferred option. RIE senior managers/directors should not be subject to the existing Approved Person regime (or, in the future, the Senior Managers and Certification Regime) as this is used for investment firms providing investment services to clients, as opposed to the operators of a trading venue/Regulated Market.

20) What factors do you think should be taken into account in relation to the drafting of the standalone power suggested at Option B? Please provide answers both in relation to the proposal for investment firms and market operators.

Since REC already includes the concept of Key Individuals for RIEs, HM Treasury should ensure that the amendments made under Option B are delimited to only give the FCA the powers to require the removal of a director to meet the MIFID II requirements and not otherwise affect the Key Individual's regime or to impose additional obligations. We would make the same point in relation to investment firms.

Organised trading facility

21) Do you agree that amendments to the RAO and the Recognition Requirements Regulations appropriately transpose the MiFID II investment service of operating an OTF? In particular, do you agree that it is unnecessary to require firms to apply for a separate dealing in investments as principal permission, in addition to the activity of operating an OTF, if they engage in matched principal trading as an operator?

LSEG believes that it would be consistent with the existing inclusion of operating an MTF under Section 25D of the RAO to include operating an OTF in a similar manner.

22) Do you have any additional comments on how the government has transposed the MiFID II OTF regime?

No response provided.

Binary options

23) Do you agree that binary options should be treated as financial instruments under the existing MiFID?

As these instruments are priced in a similar manner and have similar behaviours to normal options, we agree that they should be treated as financial instruments under the existing MiFID.

24) Do you agree with the scope of the coverage of binary options proposed in the amendment to Article 85 of the RAO? If not, what do you think the scope should be?

No response provided.