UK FINANCE

UK Finance Response to FCA CP18/28 – Brexit: proposed changes to the Handbook and Binding Technical Standards – first consultation

Introduction

UK Finance welcomes the opportunity to comment on the FCA's consultation on the proposed changes to the Handbook and Binding Technical Standards for Brexit.

UK Finance is a trade association representing nearly 300 of the leading firms providing finance, banking, markets and payments-related services in or from the UK. UK Finance has been created by combining the activities of the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association.

Our members are large and small, national and regional, domestic and international, corporate and mutual, retail and wholesale, physical and virtual, banks and non-banks. Our members' customers are individuals, corporates, charities, clubs, associations and government bodies, based in the UK and overseas, served domestically and cross-border. These customers access a wide range of financial and advisory products and services, essential to their day-to-day activities, from our members. The interests of our members' customers are at the heart of our work.

Company number: 10250295.
Registered address: UK Finance Limited, 1 Angel Court, London, EC2R 7HJ

Response to CP questions

Question 1

Do you think any of the proposals in this CP represent a significant risk to compliance for your firm in time for exit day? If yes, please specify which and explain why this is the case, including projected time needed to comply with requirements were they to come into effect on exit day.

Question 1 asks firms to consider the extent to which compliance with onshored legislation will raise significant challenges and how long they will need to adapt.

This question in itself is challenging for firms to answer in a meaningful way until there is more clarity on what the post-exit day regime will look like. To identify the changes which might cause implementation challenges (i.e. "significant compliance risk") if they were to come into effect from exit day, firms would need to devote substantial resources to carry out an impact assessment. In effect, firms would need to undertake the significant work which the regulators' published statements say is not needed yet.

In light of the unprecedented timings between legislative, regulatory finalisation and the 'go live' date, UK Finance encourages the FCA to provide firms with flexibility to adapt to the new regime and time to implement the changes required in an orderly manner. In considering how long firms will need to adapt to the proposals we suggest the FCA look back to historic examples of where firms have been required to make wholesale changes to their business (noting that such regulatory change projects have related to distinct business lines rather than the entirety of an organisation's operations). For example, the FCA's first policy statement relating to MiFID II (PS17/5) was published on 31 March 2017, giving firms just over 9 months to implement the requirements; this followed a number of years of detailed consultation at UK and European levels, during which time firms had the opportunity to consider the implications, and a postponement of a year to allow firms sufficient time to implement the reforms.

We note that in recognition of the significant work firms will need to undertake in order to implement the onshoring of legal and regulatory requirements, on 27 June 2018 HM Treasury and the UK regulators explained that they do not expect firms to start this work just yet. Further, on 8 October 2018, HM Treasury clarified that it intends to temporarily empower the FCA, and other UK financial regulators, to assist firms in transitioning to the amended regulatory regime. In paragraph 1.7 of the CP, the FCA repeats that it does not expect firms to prepare now to implement the changes set out in the CP from exit day. Firms need time to make an orderly transition and need to understand how and where relief will be granted in respect of changes to legal and regulatory requirements in order to plan accordingly. UK Finance requests that the FCA provides guidance on what the temporary transitional power will apply to on top of what HMT have already provided.

The remainder of answer 1 sets out in further detail just some of the difficulties with progressing with the proposals in this CP and makes some general comments on the FCA's application of a transitional power.

Significant challenges presented by SIs and Handbook amendments

In terms of deciding how and when to ease the implementation challenge firms are facing (i.e. to use the transitional power) different approaches will of course be needed for different areas, especially to ensure that firms are able to rely on the FCA's stated aim not to require firms themselves to carry out detailed impact assessments and gap analyses in the very short timeframe between now and exit day.

From an initial assessment we see three types of changes that present different implementation challenges and would need to be considered in terms of how transitional power could be used. These are:

1. **Documentation changes** – The changes proposed to the FCA's rules and under the draft SIs will drive changes to a firm's suite of documentation. As with any major regulatory change project, firms' require time to process the changes and implement consequential drafting amendments. In particular, where the documents are individually negotiated or, require a variation to customer terms and conditions, this could be lengthy process.

2. **Policy and procedure changes** - These changes will entail not only updating documentation and system changes but also re-training staff as relevant. As above, UK Finance suggests that the FCA bear in mind in the time required to sign off policies and procedures (some of which require Board approval) and roll-out firm wide training programmes.

3. **Reporting changes** – The changes to firm's reporting requirements will trigger change in operational systems where firms and regulators will need to be operating from the same synchronised basis. UK Finance encourages the FCA to ensure firms have enough time to make these changes to their systems to align to new requirements.

In addition, we note that the proposed power would empower the regulators to waive or modify regulatory obligations that have changed as a result of onshoring financial services legislation. The scope of the FCA's power to waive or modify under the temporary transitional power legislation would therefore need to match the scope of the power to amend.

In terms of enforcement, as mentioned above, in respect of changes in relation to onshored EU financial services regulations or delegated regulations, for clarity the FCA should confirm that it will not enforce any such legal obligations during a designated period after a hard Brexit so that it would not be seen to be itself in breach of any of its own statutory enforcement duties which could be achieved for example by making a form of binding declaration.

Non-exhaustive and illustrative examples

Listing a comprehensive set of compliance and regulatory issues will not be possible in the time available. However, we highlight the following changes in the relevant Statutory Instruments and the CP which provide an illustrative example of the types of concerns that firms may face. The implementation challenges which relate to specific changes proposed by the CP are dealt with in more detail in the relevant sections of our response.

- *BIPRU Handbook – risk weighting*

  The FCA proposes changes to BIPRU 3.4 which remove the preferential risk-weighting treatment currently afforded to exposures to EEA central governments and EEA central banks. This is in line with the baseline approach, as taken in the Capital Requirements (Amendment) (EU Exit) Regulations 2018. This is an area which would benefit in particular from use of the transitional power first to ensure firms are not disproportionately disadvantaged by the sudden increase in capital requirements and secondly to give the regulators leeway to consider potentially amending this requirement in the longer term. The transitional power could also be used similarly for firms currently relying on assessments made by EEA ECAIs which would (on the basis of the baseline approach) no longer be eligible.

  We note that the PRA in CP 25/18 confirms that for the duration of the transitional relief firms would be able to continue to treat EU27 exposures and assets preferentially (paragraph 4.10 of that CP). We also note that the CP confirms that credit unions will be able to continue placing deposits with EEA credit institutions.

- *Reporting of data*

  The changes to the requirements around transaction reporting will require firms to distinguish between UK and non-UK EEA executing firms, and will require transmitting firms to start reporting where previously they have not been obliged to do so. Current systems do not need to take this into account and therefore using the transitional power either to modify the scope of these requirements, or to give firms the opportunity to update their systems, would be necessary.

  We note that the PRA in CP 25/18 confirms that for the duration of the transitional relief firms will continue to report and disclose data on the same basis as before exit day.

- *Consumer Credit*

  The Consumer Credit SI renames the Standard European Consumer Credit Information sheet to the Standard Consumer Credit Information Sheet. This is a prescribed document that must be provided to customers in its exact form. If it is not, the consequence is that agreements are rendered unenforceable by section 65 of the Consumer Credit Act 1974 (the **CCA**). This then requires firms to technically have to apply to a court for an enforcement order in the event that a firm wishes to enforce that agreement.

Whilst this is a minor change, it will affect many thousands of standard form agreements used by lenders. These types of changes take considerable time to implement. In addition, the manner in which documentation is distributed and agreements are made means that it is possible that documentation will already have been completed by a customer, but not yet made by the lender or that older form documentation is in circulation, and needs to be recalled and fully replaced. It is not, therefore, possible for firms to work to a single "drop dead" date for the change to take effect and a period over which both forms of documentation can be used legally is needed.

In this circumstance, we are not sure that the FCA will have the power to create a transitional rule to deal with this impact. This is because the fact that an agreement is unenforceable is a general consequence of getting relevant documentation wrong. It is not confined to EU documentation or content and it is a right given to a consumer to claim in a court that an agreement is unenforceable against him/her. Action taken in respect of unenforceable agreements could give rise to a claim by a customer for breach of their rights. The FCA has no power to amend the rights given to a customer under the CCA and there are no rights reserved in the CCA to permit the FCA to waive the CCA requirements or Statutory Instruments made under it. It also has no power to amend the Statutory Instrument requirements that determine what the content of this document is (this is the power already exercised by HM Treasury in the Consumer Credit (Amendment) (EU Exit) Regulations 2018). Even if the FCA were bound not to enforce, the rights the customer has in law as created by the CCA would still stand. In our view, therefore, HM Treasury needs to consider what additional powers might be needed to deal with this.

- *Incoming EEA firms*

  We are aware that the temporary permissions regime (**TPR**) is being consulted on separately, from which incoming EEA firms will be able to benefit. However, the interaction of the TPR and the use of the temporary transitional power by UK regulators will need to be worked through to ensure that the rules with which incoming EEA firms are expect to comply, and to what extent provisions resulting from the use of the temporary transitional power will be applicable to incoming EEA firms.

Application of the transitional power

HM Treasury advises that UK regulators could grant transitional relief in relation to regulatory requirements where "*UK regulators are responsible for supervising compliance, including regulatory requirements which form part of:*

i) PRA and FCA rules made under FSMA

ii) Onshored Binding Technical Standards (BTS)

iii) Onshored EU financial services regulations or delegated regulations

iv) Relevant UK primary or secondary legislation"

But that the power will not be available to alter the following requirements:

i) "Any provision that sets the 'regulatory perimeter' for UK financial services activity

ii) FSMA threshold conditions

iii) Any provision or requirement which is not within the regulatory remit of the UK financial services regulators"

Consequently, there may be elements of HM Treasury's suite of amendments to financial services legislation where this power is not applicable. For example, we can see that this power will be available to prevent a firm being at risk of a PRA or FCA regulatory sanction as a result of the non-compliance with new post-Brexit rules on exit day. We assume that the power will also enable the FCA to modify the rules to which section 138D of FSMA applies in order to ensure that no breach of any new requirements could give rise to a right of individual rights of redress (by, for example, the FCA creating a waiver from any section 138D determinations during a transitional period). It is not, however, so clear how the FCA will have the power to modify requirements in Primary or Secondary legislation which either gives a power to a different regulator to enforce (such as any requirements which are listed under the Enterprise Act), or which provide for or create direct rights (for example rights to consumers or contractual counterparties) as a matter of law, which rights are enforced through the courts and without reference to the FCA or PRA. For impacts such as these, there is likely to be a need for some form of transitional legislation and we are not clear that the making of such legislation can be delegated by HMT to the FCA or PRA.

Taking the categories of requirements where the FCA may grant transitional relief in turn:

1. In relation to FCA rules made under FSMA and the onshored BTS, the Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (**Regulators' Powers SI**) amends FSMA to delegate powers to the FCA enabling it to amend the Handbook and BTS without following the procedures set out in FSMA. These powers are limited to remedying deficiencies or failures of EU regulations or EU derived provisions and will not cover the making of any transition provisions. The endowment of transitional powers will require the statutory process for the making of these rules to be set out within the Treasury Order. Whilst those powers may be able to be exercised without consultation, any such exercise of these powers will need to give a firm enough time to implement the changes which the FCA has provided for (or not provided for) via this process. It would seem sensible for there to be a period of consultation on any exercise of transitional powers to ensure that they properly reflect what is needed from a UK perspective.

2. In relation to onshored EU financial services regulations or delegated regulations, unlike in the situation above where the requirements are already within the framework of the FCA's rule-making powers, the FCA would not have the power to amend or waive the requirements of primary legislation and, as such, to the extent HM Treasury wishes the FCA to have powers to implement transition provisions in respect of requirements imposed by legislation, this power will need to be delegated explicitly to the FCA. We would then assume that the FCA could utilise that power by making a form

of binding declaration that it will not enforce any such legal obligations during a transitional period without it being itself in breach of any of its own statutory enforcement duties.

As set out above, we believe that a different transitional arrangement will still be required where the amendments give rise to rights that are not in the gift of the FCA to amend or remove. We see a particular impact here in relation to, for example, the consumer credit legislative changes mentioned above, but there may be others discovered as detailed thinking on implementation develops.

Question 2

Do you agree that we have correctly identified all relevant amendments in our draft Handbook and BTS text related to the cross-cutting issues set out above? Do you have any other points you wish to raise regarding our approach to these cross-cutting issues?

We welcome the FCA's approach to the cross-cutting issues set our above and consider that the policy approach underlying the amendments in the draft Handbook and BTS text related to cross-cutting issues is appropriate.

However, it is unclear whether the FCA proposes to deal with further cross-cutting issues that are not dealt with in this CP, such as amendments that are consequential to changes in the process for making equivalence determinations post-exit.

More generally, it would be helpful for firms to understand how the FCA has determined which Handbook sourcebooks have been affected by the relevant cross-cutting issues. For example, the chapter makes no reference to PERG as an affected sourcebook, or to CASS. Without information on the incidence of these issues in the sourcebooks it will be difficult for firms to offer a view on whether the FCA has correctly identified all relevant amendments.

Finally, we note that there are numerous obligations under "onshored" legislation to disclose information to the FCA and/or the PRA. Currently, it is unclear as to manner in which the UK statutory confidentiality regime will continue to operate and apply in relation to such information. Similarly, it is unclear as to how the "confidentiality gateways" will operate where a UK regulator proposes to disclose information to a regulator elsewhere in the EU. Greater clarity from the FCA on these points would be helpful.

Question 3

Are there any proposed changes reflected in the instruments in Appendix 1 that are not cross-cutting in nature (see Chapter 3) or discussed in this chapter where you think we should re-consider our approach? If so, why?

We have not undertaken a review that would identify every potential issue with the proposed changes other than the cross-cutting issues or those specifically discussed in this chapter. We did not identify any general issues that we have not identified elsewhere, but we would reiterate the following:

- The FCA should be flexible in how it allows firms to adapt to the new regime and to implement the changes – including through the introduction of transitional measures to avoid the situation where firms have to be fully compliant by 29 March 2019, in the event of hard Brexit. See our answers to questions 1 and 4, in particular.

- UK Finance is responding separately to the consultation for the temporary permissions regime (CP18/29), but in the context of the changes to the FCA rules the FCA should give further consideration to the position of third country firms who previously had passports, where there is the potential for conflict between the FCA rules and the rules they are subject to in their home state. The substituted compliance proposals in CP18/29 are helpful insofar as they go, but questions about the application of the FCA rules to such firms remain.

Question 4

Are there any proposed changes where you think we should not follow the baseline approach of treating the EEA as a third country? If so, why?

In the absence of a long-term deal allowing continued market access between the EU and the UK, we agree that the baseline approach (i.e. of treating EEA member states in the same way as other third countries) should be the default position.

In CP18/28, questions 5 to 11 address a number of specific instances where the FCA is seeking feedback on its approach to treatment of EEA member states. Where we have comments to make in response to those questions, we have set them out further below. We note however that the following issues are illustrative and non-exhaustive.

In relation to the wider issue raised in question 4 regarding the use of the baseline approach:

(a) **BIPRU Handbook**

(i) Capital treatment of exposures to the EEA

In relation to the BIPRU Handbook, we note from paragraph 4.9 of the CP that the result of the baseline approach is that preferential capital treatment for certain types of exposures originating from EU member states would cease to apply after exit day – such as exposures to EEA governments. This will potentially mean that BIPRU firms

will be subject to higher capital requirements after exit day in respect of those exposures, including where those exposures may have arisen before exit day.

In practice, we do not expect that the risks associated with those exposures will materially increase simply as a result of the UK leaving the EU. In our view, it would be appropriate for the preferential capital treatment to continue to apply in respect of EU exposures after exit day, in order to prevent a sudden increase in the capital requirements.

In the longer term, if no deal is reached for continued market access between the UK and EU, it may be appropriate for UK firms to have to hold more capital in respect of EEA exposures. However, we think that ought to be subject of further consideration in due course rather than becoming the default position automatically on Brexit.

We note from paragraph 4.9 of the CP that the FCA is considering temporary transitional arrangements in this area, and we would encourage such an approach to prevent an immediate adverse impact on the regulatory capital requirements of BIPRU firms.

(ii) Eligible external credit assessment institution (ECAIs)

The FCA proposes to delete BIPRU 3.3.6G, which states that the list of “eligible ECAIs” includes those who have been recognised as eligible for exposure risk weighting purposes by a competent authority of another EEA State. The deletion of this paragraph does not necessarily imply that ECAIs from the EEA cannot be “eligible ECAIs”, but it would be helpful if the FCA could clarify whether it anticipates that ECAIs from EEA States could continue to be eligible after exit day (and whether, in fact, it intends to continue to recognise them).

If any UK firms currently rely on assessments made by EEA ECAIs, but would be unable to do so after exit day, they would need to make new assessments in a very short period. In order to avoid this, the FCA should consider either (i) confirming that EEA ECIAs will continue to be eligible ECAIs or (ii) implementing transitional measures to allow affected UK firms more time to undertake new risk weighting exercises.

(b) **IPRU(INV) Handbook**

In chapter 9 of the IPRU(INV) Handbook, it is proposed that the guidance in 9.2.5A be deleted. This guidance notes that the Insurance Distribution Directive requires EIOPA to review the limits of indemnity every five years, and that the limits of indemnity that a firm is required to have by way of professional indemnity cover may change as a result.

After the exit day, the UK would be free not to follow any changes to the EIOPA guidance, and so it may indeed be appropriate to delete this reference. However, given that it is proposed that numerous other aspects of ESA guidance will continue to be referred to in the FCA Handbook, it may be appropriate to include a reference to the possibility that the FCA may decide to change its rules to keep in step with changes being made at an EU level.

(c) **COLL**

Please see questions 10 and 11 below regarding the FCA's specific questions relating to COLL.

In addition, there are other instances where the baseline approach has not been followed and the EEA has been given more favourable treatment than a third country firm. In most cases – such as with the information sharing provisions in COLL 11.4.2AR and 11.5.2AR – we agree with the proposed approach.

The only provision which we would question is the proposed amendment to COLL 6.9.6G(3). That provision states that the FCA is unlikely to approve the name of an authorised fund that includes the word "guaranteed" unless the guarantee is given by an authorised person or "a person which is established in an EEA State and equivalent to an authorised person". It is not clear why a guarantee given by an EEA person should automatically be regarded as acceptable in this situation. The test in COLL 6.9.6G(3)(iii) – namely that the person giving the guarantee is subject to prudential rules at least as stringent as UK law – could equally be applied to EEA entities (and, as at the exit day, we would expect that all such EEA entities would satisfy the test).

We appreciate that there may be existing UK UCITS funds that use the word "guarantee" in their name and have the guarantee provided by an entity from elsewhere in the EEA. In the unlikely event that the guarantor did not satisfy the new test, it would potentially be disruptive if the UK UCITS fund could no longer use the existing name. It may be appropriate to take a different approach in relation to existing funds, and to allow them to continue relying on a guarantee provided by an EEA entity, but for new UK UCITS funds that are established after exit day to comply with the new wording currently contained in the draft COLL 6.9.6G(3)(i) and (iii).

Please note that we have not commented on any proposed changes that relate to insurance business only.

Question 5

Do you agree with our proposal to amend the term 'regulated market' as it applies in INSPRU?

N/A

Question 6

Do you agree we should continue to permit exposure to stock-lending transactions with EEA-authorised counterparties on the same basis as under the current rules in INSPRU 3.2?

N/A

Question 7

Do you agree we should continue to allow exposure to stock-lending transactions with EEA-authorised counterparties on the same basis as under the current rules in COBS 21.3?

COBS 21.3.11R and 21.3.12R set out the conditions under which long-term insurance policy returns can be linked to stock-lending transactions.

The FCA has proposed in section 4.20 to 4.22 of CP18/28 to continue to allow exposure to stock-lending transactions with EEA-authorised counterparties, and exposure to loans or deposits made with an approved financial institution, both on the same basis as under the current rules in COBS 21.3.

Given that the FCA's proposals do not result in any change for firms, we agree with its approach.

Question 8

Do you agree we should continue to allow exposure to loans or deposits made with an approved financial institution on the same basis as under the current rules in COBS 21.3?

Please see our answer to the previous question.

Question 9

Do you agree with our proposed changes to COBS 2, 3, 6, 9, 10 and 22?

Overall, we agree with the FCA's proposed changes to COBS, 2, 3, 6, 9, 10 and 22.

COBS 6

The rules set out in COBS 6, in so far as they are relevant to packaged products, should be aligned with the PRIIPs Regulation.

Question 10

Do you agree that UK UCITS schemes should have the same freedom to invest in EEA (non-UK) assets as they do now?

The existing investment rules should continue for UK UCITS. We understand this is in line with the high-level policy as set out in the explanatory memorandum published by HM Treasury alongside the draft The Collective Investment Schemes (Amendment etc.) (EU Exit) Regulations 2018.

This is particularly important in the short term to avoid disruption immediately after exit day, as highlighted at paragraph 4.46 of the CP. If a different approach were taken and (non-UK) EEA-based investments were no longer given special treatment, this could cause some UK UCITS to breach risk-spreading limits immediately upon exit day.

Further, UK UCITS may not be able to address this cliff-edge issue simply by disposing of EEA-based investments and re-balance their holdings with UK-based investments, because this may be inconsistent with their investment policies and objectives (which may inherently relate to investments in EEA-based assets). Therefore, in the longer term, such an approach could limit consumer choice as a narrower range of UK UCITS funds would be available in the market.

Question 11

Do you agree with our proposal to amend FUND and COLL to remove references to a depositary of an authorised fund that is a UK branch of an EEA firm

We are concerned that this proposal would have a substantive impact on authorised funds that currently use the UK branch model (i.e. where they have appointed a depositary that is the UK branch of an EEA firm) as it would require these authorised funds to appoint a new UK-established depositary. Paragraph 4.49 of CP18/28 states that these funds "will have a transitional period in which to restructure their operations". However, it is not clear from the proposed amendments to COLL and FUND how this transitional period will operate. Therefore, we should be grateful for confirmation of how authorised funds can avail themselves of this transitional relief and how long this transitional period will last.

In this respect, it is important to recognise that appointing a new depositary is typically a lengthy process involving a high level of administration and cost. It will require the fund manager to carry out due diligence on a new depositary, agree new documentation and open accounts with the new depositary. As well as involving a transfer of all assets held in custody globally to the new depositary, the new depositary will need to review and verify for the first time all assets and cash that are not held in custody. The fund manager will also need to submit a material change notification to the FCA in respect of the new depositary. It may also need to notify or obtain express approval from regulatory authorities in other jurisdictions where the fund distributed. In many jurisdictions, this can be a costly and protracted process.

A further concern is that a new UK depositary may be subject to lower capital requirements than the existing EEA depositary. This may be the case, for example, if an EEA credit institution transfers its UK depositary business to a new UK entity that is a non-credit institution depositary subject to lower capital requirements outlined in COLL and FUND. In practice, this may therefore lead to an erosion in the level of protection currently enjoyed by investors in the authorised fund receiving depositary services from a highly capitalised EEA credit institution. The ability of a depositary to stand over its obligations to return lost assets held in custody is particularly important given the “strict liability” standard imposed by AIFMD and UCITS V, which we understand will be retained in UK regulation post-Brexit.

Additionally, we suggest some technical drafting comments on this question:

- The proposed amendments to FUND 3.11 appear to allow UK branches of EEA firms to act as depositaries for all UK AIFs (not just unauthorised UK AIFs). This is contrary to the stated policy intention at paragraph 4.49 of the CP.
- We think that the defined term "CRD credit institution" (as amended in the CP) should be used in COLL 6.6A.8R(2) and FUND 3.11.10R(2) and not the defined term "credit institution". This is because the definition of "credit institution" has no express jurisdictional scope, whereas "CRD credit institution" refers specifically to UK- and EEA-established credit institutions. Therefore, referring to "CRD credit institution" would be more clearly in line with the stated policy intention at paragraph 4.49 of the CP.
- The definition of "established" provides that, for the depositary of a UCITS scheme, this means "having its registered office or branch in". However, this is inconsistent with COLL 6.6B.6G which no longer includes the words "or branch" and so should be amended for consistency. In addition the proposed definition of "established" does not include the position for depositaries of authorised AIFs; this should be clarified in the definition.

Question 12

Do you foresee any specific challenges in implementing the changes described above?

We agree with the general approach to the Binding Technical Standards outlined in paragraphs 5.1 – 5.9. We have minor comments on the changes to the Binding Technical Standards set out in Appendix 2 of the consultation paper which we set out in an Annex to this response.

On the proposed sectoral changes, our comments are as follows:

MiFID

*Use of Central European Time (**CET**)*

a. Our members understand that the changes outlined in paragraph 5.29 would require firms to have regard to CET for this obligation only, whereas Greenwich Mean Time/British Summer Time (**GMT/BST**) would apply to all other obligations that were previously set to CET. Having different time-zone reference points within systems that implement MiFID II obligations is not desirable because, on balance, the risks involved in having systems that use different time-zones for different MiFID II obligations presents greater risks than the benefit of not having to change from CET for this one particular obligation.

b. In addition, whilst our members' primary preference is to have consistent time zones across the MiFID II obligations, they also consider that this should be kept as CET and not changed to GMT/BST. It is not clear that changing CET to GMT/BST is necessary as part of the approach of treating the EEA as a third country or that it is a deficiency that requires fixing. Making the change would require systems changes to be made at a point in time (Brexit day) when many other changes will need to be made and operational and systems risks are at their highest. Even where the FCA's long term preference is to change to GMT/BST, our members' view is that this is not a necessary change for Brexit and so references to CET should be kept as they are without amendment.

Transaction Reporting

a. Our members understand that the changes outlined in paragraph 5.30 would require firms to report transactions on UK trading venues to the FCA where they are a member of the venue through a UK branch of an EEA firm, but not when an EEA firm within their group is a member directly. From the point of view of the UK trading venues, we understand that UK trading venues will have to report transactions on their venue by EEA firms as they will become third-country firms and will not have an obligation to report to the FCA. UK trading venues should not, however, report for UK branches of EEA firms as after exit day these firms should be reporting to the FCA.

b. These changes will affect UK trading venues that are currently operating as regulated markets, MTFs or OTFs. Operators of such venues will need to update their systems so that they are able to capture transactions by such EEA firms and, in addition, within that group of firms the operators of the trading venues must distinguish between transactions executed by the UK branch and those executed from other locations. Compliance with this requirement in time for exit is likely to be difficult.

c. Members of trading venues will need to respond to information requests from trading venues. In addition, firms must identify which EEA firms within their groups are members of UK trading venues and will no longer be required to transaction report to the FCA. Internal systems will need to be updated to enable such firms to be able to distinguish between their reporting requirements depending on whether or not a transaction is executed from an EEA firm or a UK branch of such a firm. It may be challenging for firms to be fully compliant in time for exit.

d. Also of relevance to trade reporting, is the need for our members to have access to UK FIRDS well in advance of 29 March 2019 in order to update their systems and avoid a cliff edge situation. It may be necessary to consider ways to mitigate any disruption to transaction reporting that this transition may cause, including potential over-reporting (i.e. continued reference to the ESMA FIRDS). If this is an acceptable mitigating step, our members request that the FCA communicate this to the market as soon as possible.

e. The introduction of reporting for UK branches of EEA firms may require changes to a firm's transaction reporting operational processes and infrastructure. This will need to be coordinated and tested with the firm's ARMs. This interdependency means that the time it will take to implement changes will be longer than if the changes only affected firms individually and will depend on industry testing.

f. In addition, the changes outlined in paragraph 5.30 will require our members to identify instances where they currently transmit orders to EEA (ex-UK) firms and therefore do not transaction report, in order to begin transaction reporting from the transmitting entity. Where this firm already transaction reports in other contexts, then redrawing the scope of reporting is less onerous. Where the firm does not currently transaction report or does so only rarely but relies instead exclusively or primarily on transmission arrangements in order to comply with transaction reporting requirements, it is unlikely that they will be able to establish the systems necessary for transaction reporting in time for exit even if they make use of third party service providers to process the reports.

    i. In the scenario where UK venues are required to meet their transaction reporting requirements on behalf of non-UK firms, the UK venue must be able to distinguish between UK firms and non-UK firms. However, at the time of writing the LEI will be the same for the branch and the head office, and UK venues therefore have no method of identifying whether it is a UK or non-UK firm. We ask the FCA to consider this challenge and advise as to how firms will be able to identify which entity the trade has arisen from.

g. Compliance with the above requirements by exit day will be challenging for our members and they request that the FCA recognise that an appropriate degree of regulatory forbearance will be necessary after exit day whilst members work through the impact of and implement these changes.

Question 13

How long do you anticipate it will take to implement the changes? Please describe which changes you are referring to.

It is not possible to estimate how long it will take to implement these changes. Our members urge the FCA to consult with industry at the earliest opportunity once it is known that the UK will leave the EU without an agreement, in order to work out how long a period is needed for the industry time to adapt in a safe and orderly manner to the new regime.

Question 14

Are there any other impacts that you have identified?

Transaction reporting – personal identifiers

Article 6 of Commission Regulation 2017/590 (RTS 22) specifies that a natural person shall be identified in a transaction report using the designation resulting from the concatenation of the 2-letter country code of the nationality of the person, followed by the national client identifier listed in Annex II based on the nationality of the person.

Article 6(3) states that *"Where a natural person is a national of more than one EEA country, the country code of the nationality when sorted alphabetically by its ISO …code and the identifier of that nationality assigned in accordance with paragraph 2 shall be used. Where a natural person has a non-EEA nationality, the highest priority identifier in accordance with the field referring to 'all other countries' provided in Annex II shall be used. Where a person has EEA and non-EEA nationality, the country code of the EEA nationality and the highest priority identifier of that nationality assigned in accordance with paragraph 2 shall be used."*

The FCA proposes to amend Article 6(3) to read: *"Where a natural person is a national of more than one country, the country of the nationality which appears first in the [ISO … code] column in Annex II and the identifier of that nationality assigned in accordance with paragraph 2 shall be used."*

In our view this change should not be made because it may have a detrimental impact on the quality of data received in the reports and would be difficult for firms to implement as it will require changes to firms' reporting systems (e.g. an individual with dual nationality could have a different identifier under onshored MiFIR and under existing MiFIR. Firms' current systems only need to harvest a single identifier for an individual based on MiFIR and would therefore need to be updated to be able to identify whether an individual is operating under onshored MiFIR or MiFIR and then harvest the correct identifier).

For example, in relation to a natural person who is a dual UK and EEA country national, it is possible that the designation of the natural person could be different under UK law and under the law applicable in the EEA country. Specifically, where the EEA country of which the natural person is a citizen was previously above the UK (marked as *"GB"*) in Annex II to the technical standards and would now, for the UK onshored regime,

be below *"GB"* under the amended Annex II, the identifier for that person would be different under the UK onshored rules in comparison to the EEA rules. Surveillance systems based on the description would therefore not detect that the transactions were carried out by the same person.

In addition, even if a Withdrawal Agreement is not reached between the UK and the EU 27, we expect that European authorities (including UK authorities) will cooperate in detecting and deterring market abuse. The FCA's proposed changes would therefore make it more difficult for firms and regulators to detect market abuse.

The changes being proposed in Article 6 could lead to firms incurring significant costs and dedicating significant resources to obtaining personal information from individuals. Firms would have to take legal advice on matters ranging from privacy and sharing of information across borders to conflicts of law.

We understand that if firms will not be able to switch off trade and transaction reporting on EU instruments, then it would be acceptable for firms to overreport data to the UK authorities. Even this measure would present significant challenges as firms would need to take legal advice relating to matters that are outlined in the paragraph above.

We propose that firms to be permitted to mask certain data fields that are captured under existing regulations but will not be required under the FCA's proposed changes, or which are required under the FCA's proposed changes, but the provision of that information would put the firm in breach of the laws or regulations of a third country. Firms would then be able to submit such reports (with affected data fields being masked) to the UK regulators.

Communication with clients

COBS 4.5A provides rules and guidance on communicating with clients.

COBS 4.5A.1 states that where the information contains an indication of past performance of a financial instrument, a financial index or an investment service, investment firms shall ensure that the following conditions are satisfied:

"… (e) where the indication relies on figures denominated in a currency other than that of the Member State in which the retail client or potential retail client is resident, the currency is clearly stated, together with a warning that the return may increase or decrease as a result of currency fluctuations;"

The FCA proposes to replace this with:

"… (e) where the indication relies on figures denominated in a currency other than pounds sterling, the currency is clearly stated, together with a warning that the return may increase or decrease as a result of currency fluctuations;"

We note that while UK residents are already receiving this information in GBP, we think this could be a confusing switch for other clients and therefore suggest no change. As well as client impact, this change will also result in cost and time impacts.

Short selling regulation

Under the EU SSR, there are exemptions from the reporting requirements, the buy-in regime and restrictions on uncovered short selling for shares which are principally traded in a third country.

We note that the FCA will assume ESMA's duty for collating and publishing the list of shares principally traded in a third country. To ensure continuity, the FCA states that they may recognise ESMA's existing list for up to two years following exit day.

We would appreciate confirmation from the FCA and early notification of the FCA's final approach.

We would welcome any additional information on the status of the *"appropriate cooperation arrangements"* as referred to in Article 8(g) of the Binding Technical Standard.

We note the reference in Article 12(1)(a) that *"any calculations determining the principal trading venue are made as soon as possible after the relevant circumstances arise and in respect of the two-year period preceding the date of calculation"* and suggest that it would be more accurate to refer to a date that reflects the new UK regime. A similar point arises in respect of Article 9.

Question 15

Do you agree that we have correctly identified all relevant amendments in our draft BTS text related to the cross-cutting issues set out in Chapter 3? Are there any proposed changes in the instruments in Appendix 2 or discussed in Chapter 5 where you think we should reconsider our approach

In the time available it is difficult to determine whether the FCA has correctly identified all relevant amendments.

Question 16

Do you have any comments on the proposed guidance on our approach to EU Level 3 materials set out at Appendix 3 to this CP?

Given the volume of Level 3 materials published by the European Supervisory Authorities ("**ESAs**", and the "**Guidelines**"), UK Finance understands that the task of reviewing and transposing every item would be challenging in light of the 29 March 2019 deadline. The FCA's proposed approach retains the flexibility to adapt to the evolving political and policy landscape of Brexit.

1. Further ambiguity surrounds which of the Guidelines firms and market participants in the UK need not consider. We are aware that the ESAs maintain a record of Guidelines published and the corresponding 'comply and explain' response by competent authorities, including those of the FCA. Appendix 3 of the Consultation, moreover, sets out examples of exceptions to the FCA's expectations in relation to non-legislative EU material. To provide greater clarity to firms, it would be helpful for the FCA to confirm whether this is a complete list of circumstances in which it has informed the relevant ESA that it would not comply with part or all of a pre-exit Guidelines and, if not, to make available such a list.

2. Ongoing development of Level 3 materials: The CP notes that the FCA may consider materials produced by the ESAs post-exit, including where pre-exit material is updated, and that it will set out, where appropriate, its expectations as to how such materials should be treated. We believe that firms and market participants would benefit from further clarity as to how the FCA will approach the Guidelines on an ongoing basis. What will happen, for example, if a particularly helpful guideline is removed by the ESAs owing to the fact it no longer applies at an EU level (for instance, the original Level 1 and 2 legislation is repealed and recast) but it still has relevance in a UK context (e.g. because the UK does not repeal the "onshored" versions of that legislation). (The removal of Guidelines is a real risk given the previous withdrawal of the European Commission Q&As, noted above). Who at the FCA will be responsible for determining what to do with the Guidelines and what internal governance processes will the FCA apply to this to ensure due consideration of relevant issues and fair and consistent treatment of firms? What does the FCA expect will happen if and when the UK and EU regulatory regimes begin to diverge?

Question 17

Have you identified any specific provision in EU non-legislative material which should be specifically reviewed and amended because you think that the interpretive approach proposed will not be enough to ensure the regulatory framework remains fit for purpose? If so, please explain why you think this is the case.

There are numerous Level 3 materials that currently play a very important role in determining the understanding that market participants have of the ways in which EU legislation applies to them and to the transactions to which they are party. It is therefore difficult to list them all, but by way of example we have included a non-exhaustive selection in the table below. We have not included in the table those specific Level 3 materials that the FCA has addressed in Appendix 3 of the CP.

Level 3 document	***Why it is critical to understand whether and, if so, how that text will continue to apply in the UK***
EBA guidelines on shadow banking large exposures	The EBA published its Guidelines under its mandate 'to set appropriate aggregate limits to such exposures or tighter individual limits on exposures to shadow banking entities which carry out banking activities outside a regulated framework' (Article 395 of Regulation (EU) No 575/2013). Any uncertainty regarding the application of this material post-Brexit would result in a large gap in the current regulatory framework.
ESMA Q&As on MiFID II	In particular, guidance on the application of the market share test and the operation of the ancillary activities exemption are crucial for understanding the commodities derivatives regime.
ESMA EMIR Q&As	These are widely relied upon by market participants. They clarify, for example, the treatment of derivatives executed on non-EU exchanges or outside a regulated market but processed by an exchange and cleared by a CCP and the relationship between intragroup and external transactions for the purposes of calculating the clearing threshold.
ESMA MAR Q&As	The MAR regime is supplemented by Q&As which assist market participants in interpreting the boundaries of lawful behaviour. There were certain areas of uncertainty for buy-side participants in the directly applicable wording of the Level 1 and Level 2 MAR texts that were in need of clarification to ensure the optimal functioning of the regime that have subsequently been dealt with in the Q&As, for example, in relation to order cancellation policies and the meaning of the words "order" and "quote" in MAR and its implementing instruments.

Recitals

The recitals to the underlying EU rules have not been retained in any of the Brexit SIs published to date. This could cause uncertainty in some areas of interpretation – for example the definition of “research” which is effectively contained in the recitals of MiFID. Will the FCA will be providing further guidance on use of recitals?