

# MiFID 2

## PRA consults on implementation

March 2016

As the EU still sorts out the timing of MiFID 2 implementation, the UK authorities forge ahead. Following papers from HM Treasury and FCA, PRA is now consulting on some of the changes it intends to make to its rules to take account of MiFID 2.

### MiFID 2 implementation timeline

Currently, the MiFID 2 package is still scheduled to take effect on 3 January 2017. Member States are supposed to have finalised necessary changes to domestic laws by 3 July 2016.

It is now clear the application deadline will not be met, because of a combination of the European Commission having failed to meet its deadlines to produce level 2 legislation and endorse technical standards ESMA had produced, and significant concern that firms and trading venues would not have long enough from the time all relevant standards were finalised to put in place necessary policies and procedures. Legislation is being prepared at EU level to delay the application date and related deadlines by one year.

However, this does not mean that everything can stop for a year. The UK regulators have forged ahead, with several discussion and consultation papers already published. Now PRA has

published its first major paper, looking at changes it will need to make to its Rulebook, of which relevant firms it regulates must be aware. PRA notes there has in fact been no proposal at EU level to delay the 3 July 2016 transposition date – and indeed, many discussions around application delay have stressed the delay is to give firms time to prepare once the final rules are in place, rather than to provide a breathing space for regulators to make the final rules.

### Which firms will be affected?

The rule changes will affect PRA-designated banks, building societies, investment firms and their qualifying parent undertakings – financial holding companies and mixed financial holding companies, as well as credit institutions, investment firms and financial institutions that are subsidiaries of these firms.

### What does the paper cover?

This paper covers two specific areas:

- extension of scope from

MiFID to MiFID 2 and harmonisation of the passporting regime; and

- systems and controls for firms that undertake algorithmic trading and provide direct electronic access (DEA) to trade venues.

PRA will consult separately on other necessary rule changes.

### PRA's approach to MiFID 2 implementation

PRA notes that in some cases its existing rules are sufficient for transposition purposes, but that it has identified already several provisions within MiFID 2 and MiFIR which will require change to its rules. It has aligned its proposals to those FCA has already published.

### Passporting

PRA notes MiFID 2 makes some "small but important" changes to the current passporting regime that will affect dual-regulated firms. Specifically it extends:

- the range of passportable investment services and activities, to include the operation of an organised trading facility (OTF); and
- the range of investments to include the new instrument of emissions allowances.

PRA says existing passports will remain valid and unchanged but firms wishing to include the new activities or instruments will need to amend their passport. They should use the existing PRA procedures for a change in particulars. However, ESMA has published standard templates for notifications. Once the Commission has approved these, investment firms and, to the extent relevant, credit institutions, should use these forms. PRA proposes:

- to delete its existing forms and link directly to the EU forms; and
- to extend its current CRD 4 passport notification declaration form to notifications under MiFID 2 and make minor changes to the declaration.

Where firms want to passport MiFID activities under CRD 4, PRA will continue to process applications as it currently does and in compliance with relevant EBA forms. However, it notes that credit institutions should be aware they will need to comply with MiFID 2 standards if using MiFID 2 tied agents.

### Algorithmic trading

To date, no PRA rule has focussed on algorithmic trading. To comply with the MiFID 2 requirements, PRA proposes to

create a new part of the PRA Rulebook, called the Algorithmic Trading Part. This will apply to any CRR firm (including credit institutions) that engages in algorithmic trading or provides DEA to a trading venue.

PRA says its proposals largely mirror FCA's, and that the new Part should be read in conjunction with several existing parts of the Rulebook that address organisational requirements, systems and controls and compliance. However, it says its proposals have to focus on the safety and soundness of firms, whereas FCA's focus is on preventing abuse of the markets. PRA knows dual-regulated firms will be interested in how both regulators deal with supervising algorithmic trading and plans to provide further clarity in due course.

PRA proposes to require firms that carry out algorithmic trading to ensure their trading systems:

- are resilient and have sufficient capacity;
- are subject to appropriate trading thresholds and limits; and
- prevent the sending of erroneous orders or contribute to a disorderly market.

Firms will also need to put in place tested and monitored business continuity arrangements to guard against the risks of failure.

PRA does not propose to require firms to notify it if they engage in algorithmic trading as all firms that do so will need to notify FCA.

Similarly they may notify only FCA of the trading venue they use, but should notify PRA if there is a material change to their business. PRA also plans to impose record keeping requirements covering algorithmic trading strategies, parameters and limits and put in place specific requirements for high frequency trading.

Firms providing DEA will need to:

- put in place systems and controls;
- review suitability of clients using the service;
- prevent clients from exceeding appropriate pre-set trading and credit thresholds;
- prevent trading by clients that may cause risks to the firm; and
- keep appropriate records.

### Changes to rules

PRA has published for consultation:

- the PRA Rulebook: Passporting instrument; and
- the PRA Rulebook: CRR firms: Algorithmic trading instrument.

### What happens next?

PRA asks for comments by 27 May. It is of course consulting now without the benefit of the final form Level 2 legislation or technical standards, and may have to change its proposals once the EU finalises the delegated legislation.

It seems highly optimistic to think that the final rules will be in place by 3 July.

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