MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

May 26, 2015

Via Electronic Mail

Tom Ward
Strategy and Competition Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

By email: dp15-03@fca.org.uk

Dear Mr. Ward:

MFA response to FCA discussion paper 15/3 on MiFID II – the recording of telephone conversations and electronic communications by investment managers

Managed Funds Association ("**MFA**")[1] welcomes the opportunity to provide comments on the Financial Conduct Authority's ("**FCA**") Discussion Paper 15/3[2] (the "**DP**") on developing its approach to implementing the conduct of business and organisational requirements in the recast of the Markets in Financial Instruments Directive ("**MiFID II**")[3].

MFA appreciates the FCA's recognition in the DP that MiFID II presents a difficult legislative timetable and that there will be many challenges for the industry to implement the full package of MiFID II measures by January 2017. MFA also supports the FCA's early initiative to engage with stakeholders on its approach to implementing MiFID II.

A number of the proposals in the DP are not directly relevant to the alternative investment industry MFA represents. As a result, MFA's response is limited to the following two questions posed in the

[1] Managed Funds Association represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, D.C., is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices, learn from peers and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

[2] FCA Discussion Paper (DP15/3): *Developing our approach to implementing MiFID II conduct of business and organisational requirements* (March 2015), available at: https://www.fca.org.uk/news/dp15-03-mifid-ii-approach.

[3] Directive 2014/65/EU, available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.173.01.0349.01.ENG.

DP concerning the recording of telephone conversations and electronic communications by investment managers:

Q20: Do you agree that the two recording exemptions for discretionary investment managers should be removed?

Q21: Do you agree that discretionary investment managers should be required to comply with Article 16(7) of MiFID II?

MFA does not agree that the current recording exemptions for discretionary investment managers[4] should be removed and believes that discretionary investment managers should not be required to comply with the requirements for recording telephone conversations and electronic communications in Article 16(7) of MiFID II.

MFA submits that it would be disproportionate to subject discretionary investment managers to the taping requirements in MiFID II where the relevant conversations and communications are recorded by another firm subject to these requirements and/or, where not so recorded, those conversations and communications are infrequent and a small proportion of the total relevant conversations and communications made by the investment manager. MFA notes the original policy rationale for the exemptions was to avoid duplication as the "relevant conversations and communications should be captured through the taping obligation on 'sell-side' firms"[5]. This is also consistent with the technical advice of the Committee of European Securities Regulators ("**CESR**") to the European Commission ("**Commission**") that portfolio managers should be exempt from the MiFID II taping obligations "on grounds of proportionality" where they transmit decisions to deal to an entity under an obligation to record that conversation or communication[6].

On the whole, MFA believes that the costs associated with extending the MiFID II taping requirements to discretionary investment managers would far exceed any potential benefit which would be derived. In addition, MFA is concerned that, in a time when operating costs have risen dramatically as a result of changes to the financial services regulatory framework, the barriers to entry have been raised significantly, particularly for smaller asset managers.

Significant Costs

MFA highlights that, as the FCA's predecessor, the Financial Services Authority ("**FSA**") previously observed, the costs of extending taping requirements to discretionary investment managers are likely to be significant. Both when the FSA first introduced its requirements for recording landline telephone

---

[4] *See* COBS 11.8.6R(2) and (3).

[5] Financial Services Authority ("**FSA**") Policy Statement (PS08/1): *Telephone Recording: recording of voice conversations and electronic communications* (March 2008), at para. 2.16, available at: http://www.fsa.gov.uk/pubs/policy/ps08_01.pdf.

[6] CESR: *Technical Advice to the European Commission in the context of the MiFID Review – Investor Protection and Intermediaries* (CESR10-859) dated 29 July 2010, at paras. 37 and 38 available at: http://www.esma.europa.eu/system/files/10_859_Technical_Advice_MiFID_Review_Investor_Protection_and_Intermediaries.pdf.

conversations and electronic communications in 2008[7] and later when it extended those requirements to mobile communications in 2010[8], the FSA noted that the exemptions for discretionary investment managers represented a reduction of up to 20% in the overall costs associated with the taping requirements. Based on this historic data, adjusted for inflation and taking into account the likely increased reliance of firms on mobile technology and the additional requirements of MiFID II, it is apparent that if the FCA were to remove these exemptions, this would likely cost the asset management industry tens of millions of pounds, if not more. As these potential costs are substantial, MFA urges the FCA to assess closely the potential impact on the asset management industry if it were to consult on removing the recording exemptions. This impact assessment should include, as previously, carrying out a survey of investment managers and commissioning an independent study of current recording technologies and their associated costs. MFA is concerned that the DP does not explain whether the FCA has considered these costs.

Need for Balanced Approach

By comparison, the potential benefits associated with removing the recording exemptions for discretionary investment managers are likely to be minimal relative to the significant costs. In the DP, the FCA states (without explaining the relevance to the asset management industry) that the recording of relevant conversations and communications by discretionary investment manages will help the FCA to:

(a) detect and deter market abuse;
(b) assess firms' ongoing compliance with their conduct of business obligations; and
(c) ensure that there is evidence to resolve disputes between firms and their clients over the terms of a transaction.

However, as the above are the same reasons given by the FCA for introducing the taping requirements for brokers and other firms that execute and/or receive and transmit client orders, it is not clear if the FCA has observed a regulatory and/or market failure specific to the asset management industry that is sufficient to justify the removal of the exemptions.

We would like to address each of the above points in relation to discretionary investment managers.

Detecting and deterring market abuse

The FSA noted in PS08/1 that there should be "no significant loss of evidence" to detect or deter market abuse as a result of the operation of the exemptions for discretionary investment managers.[9] This is because the counterparty to the relevant conversations and communications (e.g. the broker that is participating directly in the relevant market) should be subject to the relevant recording obligations or, if not, the relevant conversations and communications should only occur on an infrequent basis.

---

[7] *See* FSA PS08/1 at paras. 2.16 and 2.49.

[8] *See* FSA Consultation Paper (CP10/7): *Taping: Removing the mobile phone exemption* (March 2010), at. paras. 2.16 and 2.17, available at: http://www.fsa.gov.uk/pubs/cp/cp10_07.pdf.

[9] *See* FSA PS08/1 at paras. 2.16.

Assessing firms' ongoing compliance with their conduct of business obligations

MFA recognises that, in some instances, if discretionary investment managers were fully subject to the taping requirements in MiFID II, this could provide supervisors an advantage when monitoring a manager's compliance with its conduct of business obligations. For example, if investment managers recorded each of their conversations and communications when transmitting a decision to deal to an executing broker, this would save the supervisor the time and effort of coordinating directly with that executing broker to obtain a copy of the relevant conversations or communications.

However, it seems unlikely that requiring discretionary investment managers to tape relevant conversations and communications with an executing broker would provide a material benefit to the FCA and/or not a benefit that would outweigh the likely significant costs noted above that the asset management industry would incur as a result. The FCA does not suggest it that it has to date experienced significant difficulties in obtaining from executing brokers the evidence it requires to effectively supervise investment managers, or that it expects to face such difficulties going into the MiFID II regime. MFA also highlights that portfolio managers will remain subject to a general obligation under Article 16(6) of MiFID II to keep records of all services, activities and transactions sufficient to enable a competent authority, such as the FCA, to fulfil its supervisory tasks and perform enforcement actions. As a result, MFA submits that it would be unnecessarily duplicative and disproportionate to impose a cost on the asset management industry to record relevant conversations and communications under Article 16(7) of MiFID II when the relevant records should already be available to supervisors.

Ensuring that there is evidence to resolve disputes between firms and their clients

When the FCA refers to the resolution of disputes between "firms and their clients", we assume that is a reference to the investment manager and its client (as opposed to the broker as firm and investment manager as client of the broker).

In this regard, MFA is of the view that the recording of conversations and communications is unlikely to make a material difference in the resolution of disputes between an investment manager and its clients over the terms of a transaction. This is especially the case in the context of discretionary investment management, where by definition the terms of a transaction are at the discretion of the relevant investment manager rather than a client's specific instructions. The relevant taping obligations were also never intended to cover situations where an investment firm is discussing its portfolio management services with a client[10]. Moreover, where the relevant client is not a retail client, there is no need for the FCA to intervene for dispute resolution purposes. In these circumstances, each party should be sufficiently sophisticated to manage its legal risks and decide whether taping is necessary to resolve potential disputes.

Instead, the benefits for dispute resolution will likely only ever arise in the context of disputes between a client and its broker as to the terms on which that client instructed the broker to execute a given

[10] *See* CESR10-859 at para. 38, which states: "…the recording obligations are not intended to cover situations where an investment firm is discussing the portfolio management agreement with a client."

transaction, in which case a recording of the call would already be in existence at the broker.

****

MFA thanks the FCA for the opportunity to share the above comments and remains available to discuss its members' view on this topic in greater detail. Please do not hesitate to contact Jennifer Han, Associate General Counsel, or me at +1 (202) 730-2600 with any questions that the FCA or its staff might have.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President, Managing Director &
General Counsel