Changes to UK MIFID's conduct and organisational requirements

Consultation Paper
CP21/9**

April 2021

How to respond

We are asking for comments on this Consultation Paper (CP) by **23 June 2021**.

You can send them to us using the form via our website.

Or in writing to:

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Telephone:
020 706 69280

Moving around this document
Use your browser's bookmarks and tools to navigate. To **search** on a PC use Ctrl+F or Command+F on MACs.

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Contents by sector

This table sets out which chapters are particularly relevant for each sector. This is where you will find the most relevant chapter(s) for your firm.

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Eg, Credit unions	2, 3, 13

1 Summary

Why we are consulting

1.1 The UK Markets in Financial Instruments Directive (MiFID) is the collection of laws and rules that regulates the buying, selling and organised trading of financial instruments. It derives from European Union (EU) legislation which first took effect in November 2007 and was significantly amended in January 2018 (MiFID II). The UK laws and regulations implementing MiFID II were modified to address deficiencies as part of the process of onshoring EU law. This enables UK laws and regulations to function effectively after the end of the Brexit transition period.

1.2 We are working with HM Treasury on capital markets reform, which is explained in more detail in Chapter 2. This involves looking at the UK's regulatory regime for capital markets to develop a package of changes. These changes are to ensure the regulation of investment business in the UK is adapted to the broad and deep structures of UK markets, underpinned by the highest regulatory standards that promote market integrity, effective competition and consumer protection.

1.3 As part of the capital markets reform work, this first consultation covers changes in two areas to the conduct and organisational rules in UK MiFID. We have spoken to a range of market participants about reforms we can make to ensure the rules achieve their objectives and reduce compliance costs without compromising high standards of investor protection.

1.4 We considered responses that UK market participants gave to a consultation the European Commission ran last year on possible changes to MiFID II. That consultation led on to the so-called 'quick-fix' changes to MiFID II that the EU has enacted as part of what has been described as a Capital Markets Recovery Package, to support post-Covid 19 economic recovery. The changes we are proposing to UK MiFID through this consultation includes changes in two areas covered by that package. Several other changes in that package we believe are best made through changes to the UK MiFID delegated regulation. The Treasury will propose changes to the delegated regulation in due course.

1.5 We have considered issues in the light of our objectives, the specificities of the UK market and the letter of 23 March 2021 from the Chancellor to our Chief Executive. That letter recommends the aspects of government economic policy that we should have regard to in deciding how to act. We have focused on amending UK MiFID requirements that are not achieving their objectives in an efficient way. Our proposals aim to reduce burdens on investment firms while having regard to growth and the competitiveness of UK financial services.

Who this applies to

1.6 Our proposals will affect

- investment firms and market operators in the UK
- banks and Collective Investment Scheme operators providing investment services
- persons providing investment advice and reception and transmission of orders who did not opt into MiFID ('Article 3' firms)
- persons providing research that we do not authorise.

1.7 Our consultation will also be of interest to individuals who use the services of the firms mentioned above as well as firms not authorised to provide investment services but that use the services of firms providing investment services, including pension funds and corporates. The research proposals are also relevant to small companies whose shares are traded on public markets.

Summary of proposals

SME and Fixed Income, Currencies and Commodities (FICC) research

1.8 We propose to change the existing inducements rules relating to research. These changes broadens the list of what are considered minor non-monetary benefits to include research on SMEs with a market cap below £200m and FICC research, so that it is not subject to the inducement rules. We have also made rule changes on how inducement rules apply to openly available research and research provided by independent research providers.

Best execution reports

1.9 We propose to remove two sets of reporting obligations on firms:

- the obligation on execution venues to publish a report on a variety of execution quality metrics to enable market participants to compare execution quality at different venues (known as RTS 27 reports)
- the obligation on investment firms who execute orders to produce an annual report setting out the top 5 venues used for executing client orders and a summary of the execution outcomes achieved (known as RTS 28 reports)

Measuring success

1.10 We will measure the effect of our proposed rule changes through our general feedback from firms on whether they have utilised these proposals.

Next steps

1.11 We want to know what you think of our proposals in this paper. Please send your comments to us by 23 June 2021, using one of the methods in the 'How to respond' section on page 2. Unless you have indicated that your response is confidential, we will not treat it as such.

1.12 We will consider your feedback. If we choose to proceed, we would publish any rules or guidance in a Policy Statement in the second half of 2021.

2 The wider context

2.1 As noted above, the proposals in this consultation are a part of a capital markets review we are conducting with the Treasury. Following the onshoring of EU legislation, UK MiFID is now spread across primary and secondary legislation, our Handbook and technical standards. An effective review process therefore requires us to work in close cooperation with the Treasury to ensure that issues can be addressed in a coherent, holistic way.

2.2 Our shared objectives with the Treasury for the capital markets reform work are to have a regime of capital markets regulation with the following characteristics.

- **High standards.** A regime characterised by robust standards that are effectively enforced, adhering to the highest international standards and ensuring that market participants can operate in it with confidence and maintain trust in the operation of the market.
- **Supporting economic growth.** A regime that supports growth in the real economy, innovation, entrepreneurship and wealth creation across society, and facilitates investment, both in the short-term (by supporting the economic recovery from COVID-19) and sustainable long-term (as we transition to a low-carbon economy).
- **Open and competitive markets.** A regime that allows a range of participants (domestic, international, public/private sector organisations) to access UK markets easily, appropriately and at a low cost, with high levels of competition and innovation, cementing the UK's position as a global hub for wholesale markets business.
- **Fair and proportionate.** A regime that is underpinned by proportionate standards that are focused on outcomes rather than prescriptive rules and strong infrastructures that enable market participants to operate in the market without unnecessary friction and costs.

2.3 The capital markets reform work is looking at priority areas including:

- market structure
- pre- and post-trade transparency for shares, bonds and derivatives
- the cost and distribution of market data
- commodity derivatives markets

2.4 With the Treasury we have already met with market participants this year to discuss capital markets reform. This follows on from discussions about possible changes to UK MiFID over the previous 18 months, including discussing issues raised in consultations by the German Finance Ministry, the European Commission and European Securities and Markets Authority (ESMA). This dialogue will continue throughout this year as we look in detail at a range of issues and ideas.

2.5 Following this consultation paper, in the summer a consultation paper by the Treasury will look at the broad themes of capital markets reform and cover a range of high-level and more detailed questions. It will help prepare the ground, in due course, for proposals for changes to primary legislation, as well as helping to establish changes that could be made more quickly through secondary legislation.

2.6 We will publish at least two further consultation papers this year. Before the summer, one will look at the consequences of LIBOR transition for the Derivatives Trading Obligation. After the summer, another will cover changes to markets requirements in the Handbook and technical standards that can be effective without significant supporting legislative change.

2.7 As mentioned in Chapter 1, the EU has introduced several changes to MiFID in a so-called quick-fix package. That package contains the following elements in the areas covered by this consultation:

Table 1 Measures in the EU MiFID II Quick-Fix legislative package

Policy area	Rationale for change stated by the European Commission	Changes to MiFID II
Research	• Enhance investment eco-system for publicly traded SMEs taking account of Covid 19 pandemic. • Address mid-term decline in SME research coverage predating MiFID II.	• Permit re-bundling for research and execution costs for research on firms <EUR 1billion.
Best execution reports	• Reports overly complex, unhelpful and as a result are not used.	• Venues (RTS 27) suspend reports for two years from end of February 2021.

2.8 The changes the EU made reflected feedback from market participants – including UK market participants – on where the legislation was not working well. Therefore, in talking to UK market participants about possible changes to UK MiFID that could be delivered in the short term, similar issues have been raised with us. As a consequence, the issues in this consultation are in areas covered by the EU quick-fix. However, the proposals we are making differ as they reflect the different circumstances in the UK and our own analysis. Other areas in the EU quick-fix where we consider there is a case for change in the UK either require legislative change or would be best achieved by legislative change. The Treasury intends to propose changes to the delegated regulation in due course. These would include changes related to costs and charges disclosure for wholesale clients, electronic communications with clients, reporting to wholesale clients and changes to provisions linked to RTS 27 and 28.

How it links to our objectives

Make markets work well

2.9 The changes we are proposing to the UK MiFID rules are intended to ensure that our requirements are better tailored and more proportionate to the risks arising. This should remove unnecessary regulation, make the requirements less complex and make these markets work better.

Consumer protection

2.10 One of our operational objectives is to secure an appropriate degree of protection for consumers.

2.11 In the case of the inducements regime, we are mostly maintaining existing protections that reduce scope for conflicts of interests and enhance transparency for investors. However, the amount of SME research produced is limited; demand for it is limited; and inducement risk – below a market cap of £200m – is limited. We explain below that it will be unlikely that material costs will be transferred back to clients through SME research subsidised by inflated transaction costs.

2.12 For best execution our proposals remove some regulatory requirements that carry costs but have not delivered hoped-for benefits.

Competition

2.13 We expect only our proposals on research to have material competition implications. We expect these to have positive impacts arising from improved research coverage. An increase in asset manager interest and liquidity for SME firms may result. We recognise some potential impacts on competition, such as pushing trading to brokers offering execution and research rather than just execution and reduced price transparency. But we consider the effects are likely to be limited given the current low levels of research for firms of this size. We also consider the impacts of our proposals on research on fixed income, currencies and commodities for competition to be limited. This is because this research applies to a section of the market where the connection between execution decisions and the provision of research is weak.

Wider effects of this consultation

2.14 Annex 1 sets out our analysis of benefits and costs to firms and consumers from our proposals.

Equality and diversity considerations

2.15 We have considered the equality and diversity issues that may arise from the proposals in this Consultation Paper (CP).

2.16 We have assessed these proposals do not have an Equality and Diversity impact but we will continue to consider the equality and diversity implications of the proposals during the consultation period and will revisit them when making the final rules.

3 Our proposals

Introduction

3.1 In this chapter we set out our proposals on:

- SME and FICC research inducement rules
- best execution reports

How investment research is paid for

3.2 In this section, we set out the following proposals.

i. An exemption from the inducement rules for research on listed or unlisted SMEs companies who have a market capitalisation below £200m provided it is offered on a rebundled basis or for free.
ii. An exemption from the inducement rules for third party research received in connection with investment strategies that relate primarily to fixed income currencies and commodities (FICC) instruments.
iii. An exemption from the inducement rules for research received by independent research providers where this does not involve execution.
iv. An exemption from the inducement rules for openly available written material.

3.3 Investment research provides a crucial role in providing information to potential and existing investors to allow them to understand a publicly traded company and assess the risks connected with the investment. Historically, brokerage firms typically 'bundled' research costs for shares with transaction commissions (ie the cost charged to clients to trade in shares). However, MiFID II introduced requirements to set separate charges for transactions and research (thereby 'unbundling' these two services). Firms receiving research were required to either pay for research themselves from their own resources or agree a separate research charge with their clients.

3.4 The policy objectives of the MiFID II reforms were to improve accountability over costs passed to customers and improve price transparency for both research and execution services. The reforms reduced conflicts of interests in firms by fully unbundling research-buying decisions from trade-execution decisions. We fully support this objective and consider that the changes have brought improvements to the benefit of the end-investor. They are paying lower charges and receiving better quality execution services.

3.5 However, the MiFID II requirements apply to research regardless of the market capitalisation and size of the firm. This means that there is no differentiated treatment or exemption for different parts of the equity market. But some parts, eg SME research, are less likely to give rise to the harms that can be caused by bundling the two services. This is because of the lower levels of transactions in these segments and therefore lower incentives on offer. Before implementation of MiFID II, Policy

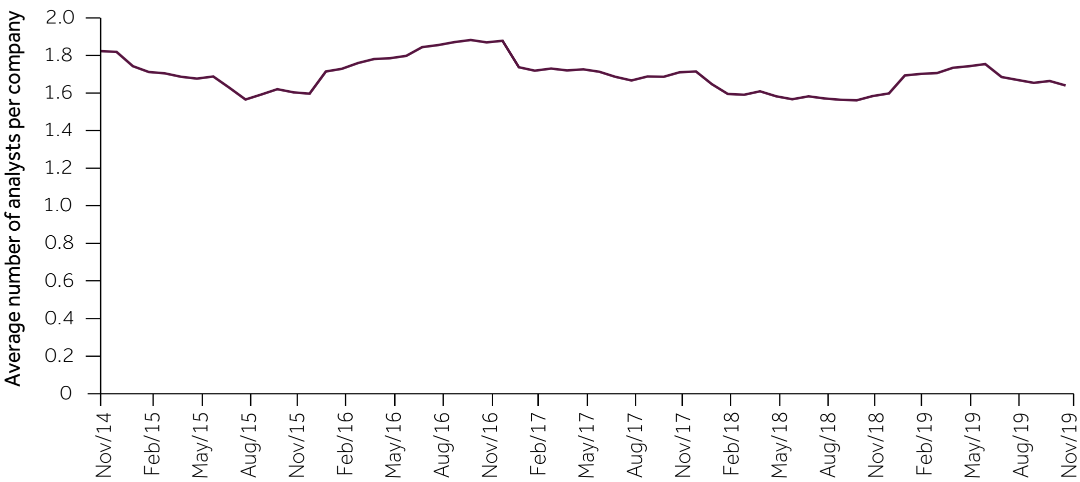
Statement 17/14 included our final rules on unbundling. It said we would remain open to considering the need for, and merit of, further measures to support SME research where robust evidence from stakeholders suggested that such clarification would help support the functioning of markets without distorting execution decisions.

Analysis

3.6 Our supervisory work found buy-side budgets for equity research have declined about 20-30% following MiFID II. We found that most firms now absorb these costs directly rather than passing them on to clients. This has resulted in substantial savings to investors in equity portfolios, but creates revenue pressure on research providers (banks, brokers, independent research providers). Buy-side firms have, however, stated that they still get the research they need, and sell-side firms also claim to have maintained SME coverage.

3.7 Our analysis has not found that introducing research and unbundling requirements within MiFID II has significantly affected research analyst coverage for smaller UK public companies. But the coverage level was already low. For instance, Figure 1 shows that the number of research analysts covering public companies with a market cap lower than £1bn has remained generally constant since MiFID II took effect in January 2018, at an average of 1.6 analysts per company.

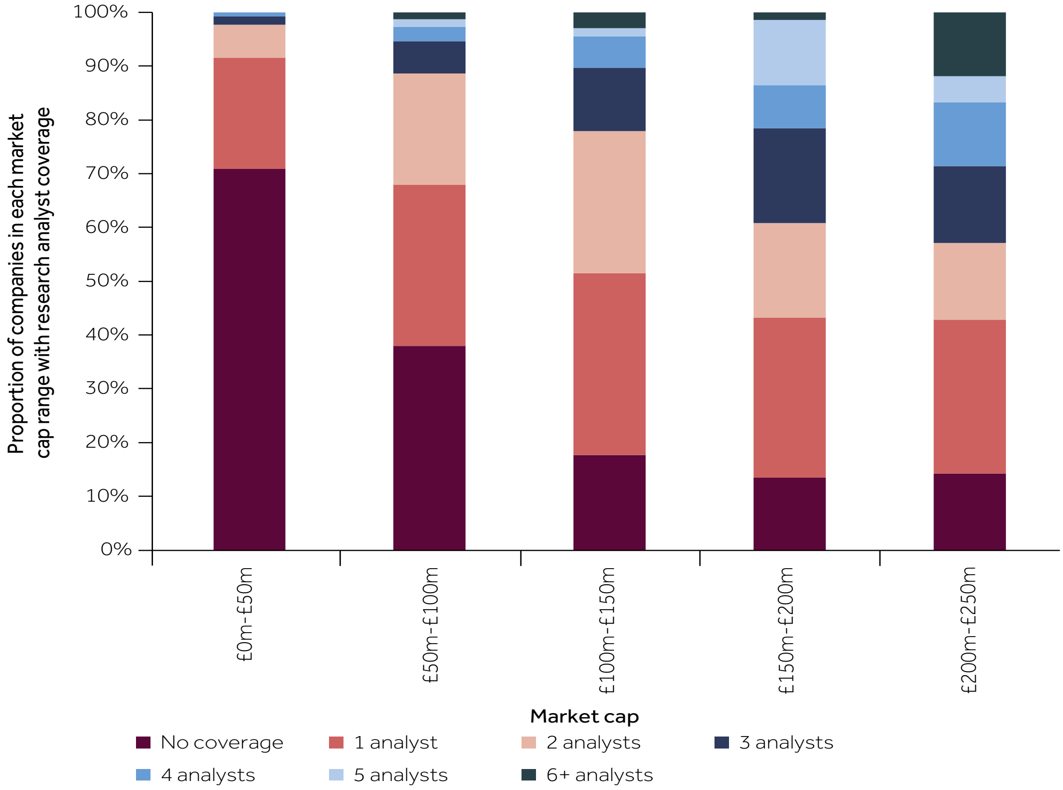
Figure 1: average number of research analysts covering companies with a market cap less than £1bn



Source: FCA, Bloomberg

3.8 However, average analyst coverage figures mask the fact that a significant proportion of companies at the lower end of the market cap spectrum are without coverage. Figure 2 shows that many public companies with market caps below £250m have no researcher. 79% of public companies with a sub-£250m market cap have either no research coverage or are covered by a sole analyst – levels of coverage which may be insufficient to provide a fully informed view for investors.

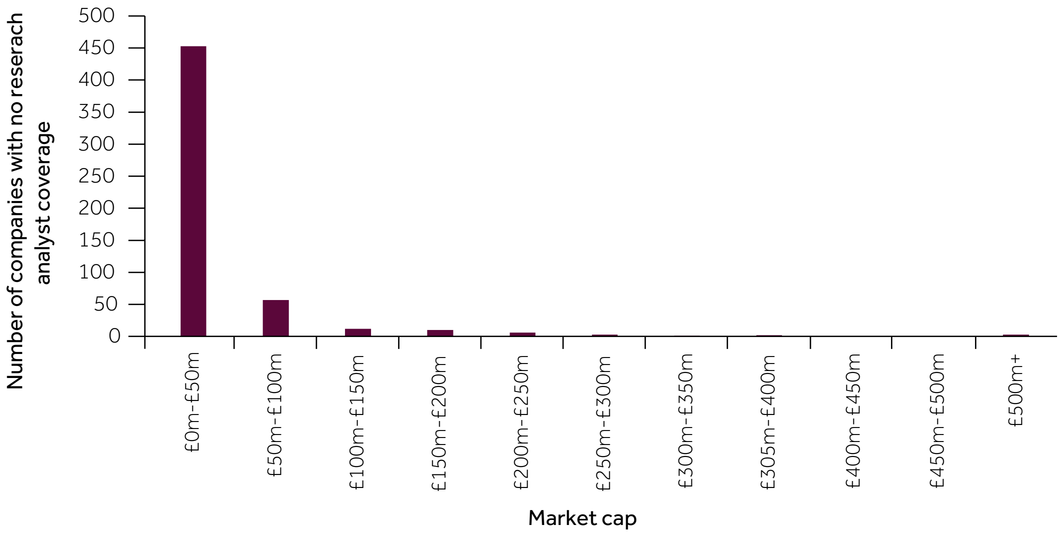
Figure 2: level of research analyst coverage based on company market cap



Source: FCA, Bloomberg

3.9 Looking at where no research analyst coverage exists, and therefore where we should direct our policy proposals, it is indeed small-cap companies which are not covered. Figure 3 shows that, of the 547 companies that have no research analyst coverage, around 98%, have a market cap below £250m. Comparing these figures to the wider population of companies, this means that around 28% of all UK publicly quoted companies have no research analyst coverage[1].

Figure 3: companies with no research analyst coverage, based on company market cap

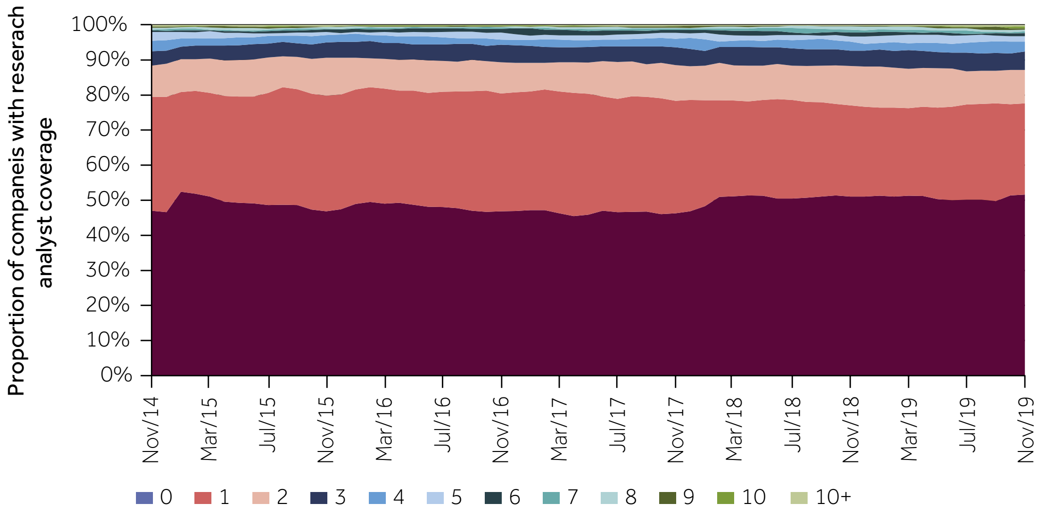


Source: FCA, Bloomberg

1 Source: London Stock Exchange.

3.10 We also conducted quantitative analysis on the population of AIM-quoted companies, as another proxy for SME firms. Analysis over a five-year period, which can be observed in Figure 4, shows a slight shift to 'multiple coverage' (2+ analysts) since MiFID II; 'high coverage' (3+ analysts) has increased from c.11% to c.16%. However, at the same, the number of AIM-quoted companies with no research coverage has also increased post-MiFID II, from around 40% to around 44%.

Figure 4: average level of research analyst coverage over time, for AIM-quoted companies

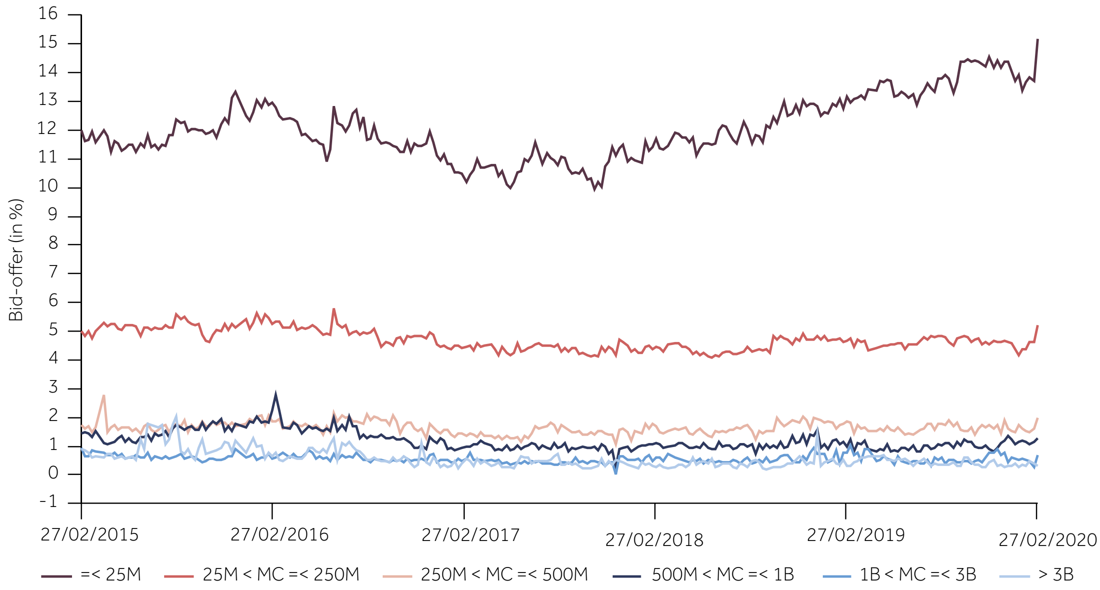


Source: FCA, Bloomberg

3.11 Our findings on low levels of research analyst coverage are likely to reflect the fact that many of these companies are very small or micro market cap. At this end of the spectrum, the volume of trades in their shares every day is small. It may therefore be harder to justify the cost of supporting a sell-side research analyst to maintain the liquidity in these companies' equities.

3.12 Our research indicates that bid-offer spreads for small- and mid-cap companies are significantly wider than for larger companies. Our analysis on this shows that the average bid-ask spread for AIM-quoted companies with a market cap below £250m is 4.9%. This compares to AIM-quoted companies with a market cap between £1-3bn, whose average bid-ask spread is 1.2%, and to FTSE100 companies larger than £3bn with a spread of 0.08%. This suggests that the size of the spread partly reflects the lower amount of information publicly available on SMEs.

Figure 5: average spreads by market capitalisation buckets, January 2015 – February 2020



Source: FCA, Datastream

3.13 Most corporate issuers we spoke to have not seen negative impacts from MiFID II on coverage of their companies' ability to raise capital. However, some had concerns about future research coverage and quality, including:

- sell-side research analyst numbers declining, as research providers become increasingly unable to maintain existing levels of staffing
- the number of companies covered by each analyst increasing, meaning that analysts are spending less time covering each company
- seniority of analysts is declining as affected companies become covered by more junior analysts

3.14 We believe the above analysis evidences a negative impact on market functionality. This supports us revisiting the policy on unbundling for research on UK SMEs.

3.15 This picture must also be seen in the wider context of SME financing beyond research. We are considering broader changes as part of the FCA's Primary Markets Effectiveness Review to maintain the UK's leading primary markets position post-EU exit, and to support recapitalisation of UK businesses following Covid. For SMEs, this includes considering improvements on how they access traded markets, including the possibility of alternative venues that are better tailored to smaller companies.

Proposals

Introduction

3.16 We have reviewed the inducement rules for research to identify what change, if any, can be made to reduce the regulatory barriers to producing and using research, particularly SME research. In doing so, we recognise that changes to the inducement rules alone are unlikely to address low research for SMEs and the degree of market functionality that stems from it. We should therefore regard these changes as part of an overall SME strategy set out in Chapter 2.

3.17 We acknowledge that firms who have established systems and procedures to meet MiFID II requirements on unbundling and have agreements in place with their clients cannot easily reverse out of these arrangements.

3.18 Many other factors outside MiFID II affect the demand for, and viability of, promoting SME research. Asset managers may be limited in their ability to invest in small-cap firms due to fund or mandate restrictions on concentration or liquidity risk. Another factor is the limited primary or secondary market activity across listed SMEs that reduces effective cross-subsidy for multi-service brokers to produce 'independent' coverage of companies. Further, the shift towards passively over actively managed funds also reduces asset managers' demand (and fee revenues) to pay for SME coverage in turn reducing the available 'wallet' for the sell-side. Lastly, high fixed costs of initiating individual company coverage persist.

Exemption for SME research

3.19 Unbundling has improved the asset management and research market by reducing costs and conflicts of interest caused by inducements, and by improving competition for research and execution services to the benefit of the end-investor. We therefore do not see merit in reversing the important benefits for investors that have arisen from such unbundling across a wider range of companies.

3.20 However, based on the data on market function and research coverage above, we propose creating an exemption from the inducement rules for SME research below a market capitalisation of £200 million to reflect and address the potential market failure in the form of low levels of coverage in research. The £200m threshold would be assessed for the 36 calendar months preceding the provision of the research, provided it is offered on a rebundled basis or for free.

3.21 Under the exemption, research on firms below the market capitalisation of £200m that is provided on a rebundled basis or for free would constitute an acceptable minor non-monetary benefit. It would therefore not be capable of constituting an inducement under our rules. Extending the list of minor non-monetary benefits to include SME research would make it administratively easier and cheaper for providers to adopt.

3.22 Our analysis indicates that our proposed £200m threshold better targets SME companies where investment research coverage is at its poorest. 2019 data indicate that above this threshold almost all companies (97.4%) have some form of coverage already. Market caps of companies with no research coverage range between £0.4m-c.£700m, with a median of £115m. Furthermore, December 2020 trading data show that companies with a market cap below this proposed threshold comprise 2.5% of total volumes traded on the LSE.

3.23 We consider that creating an exemption at this threshold presents low risks of material inducement or conflict risks, reflecting the low levels of SME transactions and small amount of research coverage. We also consider the risk to investors is low, as even though there may be an element of cross-subsidy to pay for 'free' research, we would expect this to be small. Our view is that such simplification would make this option administratively more attractive without posing significant risks given the low volumes involved.

3.24 We have also considered an alternative measure to address the market failure of low research coverage. This would be for a market-led initiative to create a research pool. Relevant firms would fund this by contributions from their own profit and loss accounts. SME research could be commissioned using these funds and then shared among contributors. Industry participants have indicated some willingness for such an initiative but were uncertain who would take forward such a proposal.

Q1: a. **Do you agree with our proposal to create an exemption for SME research below £200m provided the research is offered on a rebundled basis or for? [Yes/No/No view]**

b. **If yes or no, please explain your views.**

Q2: a. **Would you be likely to take advantage of the proposal to rebundle for SME research coverage? [Yes/No/No view]**

b. **If yes or no, please explain your views.**

Q3: a. **Do you agree that an industry-led initiative to fund research would be capable of addressing low coverage of SMEs? [Yes/No/No view]**

b. **If yes, we would welcome your suggestions on how this can be developed.**

c. **If yes or no, please explain your views.**

Exemption for FICC research

3.25 We propose creating an exemption from the inducements rules for third party research that is received by a firm providing investment services or ancillary services to clients, where it is received in connection with an investment strategy primarily relating to FICC instruments. We propose to allow FICC research to be rebundled.

3.26 The rationale is that FICC transactions are typically not paid for by an agency commission to the broker, but instead the broker earns its revenues from the spread (the gap between the bid and ask prices of an instrument). Therefore, the proposed exemption for FICC research does not create the same opacity risks between transaction fees and research costs that arise for equity research.

3.27 We recognise that the proposed exemption for FICC research, that would permit research to be rebundled, will not necessarily increase demand and supply. However, it will remove associated costs from applying the inducement rules, creating savings for producers and recipients of FICC research. Because the classification of FICC research at times includes other research, such as macroeconomic research, it is not possible to assess the impacts of MiFID II on supply and demand of FICC research. However, our engagement with industry suggests inducement activity post-MiFID II has not been significantly affected. If research had been a material part of a broker's costs, we would have expected the inducement rules to have resulted in a narrowing of spreads as a result of decoupling of research from trading spreads. However, industry feedback suggests this has not materialised. Therefore, exempting the rules for FICC research should not increase inducement risks.

Q4: a. Do you agree with our proposal to include in the list of minor non-monetary benefits third party research received in connection with investment strategies primarily relating to FICC instruments? [Yes/No/No view]

b. If yes or no, please explain your views.

Independent Research Providers

3.28 We propose to create an exemption for research provided by independent research providers, by including in the list of minor non-monetary benefits research provided by independent research providers, where the independent research provider is not engaged in execution services and is not part of a financial services group that includes an investment firm that offers execution or brokerage services. We consider this will have limited, one-off costs and offers modest benefits in terms of competition in the production of investment research.

3.29 Independent Research Providers (IRPs) only account for a small proportion of the overall research market, including for SME research. But they provide an alternative source of research to that provided by investment firms. If they do not include execution when they provide research, their research does not raise the conflicts that can arise from investment firms providing research and offering execution services.

3.30 We consider that this proposal would pose little risk, as the exemption will only apply to IRPs who are not engaged directly, or in the same group as a firm engaged in, execution and brokerage services. This clarification could help address uncertainty among those who buy research, and could encourage take-up of independent research.

Q5: a. Do you agree with our proposal to include research provided by IRPs in the list of minor non-monetary benefits? [Yes/No/No view]

b. If yes or no, please explain your views.

Q6: a. Do you agree with the circumstances in which the exemption applies i.e. where the IRP is not engaged directly or indirectly in execution services? [Yes/No/No view]

b. If yes or no, please explain your views.

Openly available research

3.31 We propose to include in the list of minor non-monetary benefits written material that is made openly available from a third party to any firms wishing to receive it or to the general public.

3.32 In this context, "openly available" means that there are no conditions or barriers to accessing it, for example requiring a log-in, sign up or submission of user information by a firm or member of the public in order to access that material. We consider this approach means investment managers can consume any such research without restriction; it might provide an incentive for entities such as trading venues in the UK to offer research on this basis.

Q7: **a.** **Do you agree with our proposal to include in the list of minor non-monetary benefits openly available written material? [Yes/No/No view]**

b. **If yes or no, please explain your views.**

Best execution reports

Introduction

3.33 MiFID II introduced reporting requirements for execution venues (RTS 27) and for firms executing and transmitting client orders (RTS 28) to make public information on execution quality and order routing. The aim was to improve investor protection and transparency in how firms execute client orders.

3.34 RTS 27 requires execution venues to publish quarterly execution quality metrics at the level of individual financial instruments. RTS 28 requires executing firms to publish an annual report listing the top five execution venues where they have sent client orders in the preceding year, and a summary of the execution outcomes they have achieved. Firms who carry out portfolio management or reception and transmission of orders are bound by a discrete obligation in secondary legislation (the UK MiFID delegated regulation) to produce reports consistent with RTS 28.

3.35 The reports are intended for market participants and clients rather than the regulator. The intention was that the information from the RTS 27 reports would enable market participants to better compare different execution venues and help them choose venues that best enable them to meet their best execution obligations. RTS 28 reports aimed to improve the information that market participants had to assess. This allows them to scrutinise the execution service their brokers provided and enables market participants to better evaluate and challenge their service providers.

Analysis

3.36 Our policy work and discussions with market participants indicate that RTS 27 and RTS 28 have not achieved their policy goal of enhancing investor protection or improving information on execution quality and order routing. We have found that the intended audiences for the reports, including retail and wholesale market participants, do not view the reports. For example, a small sample of firms reveals that, on average, there were fewer than 10 downloads of the data per month or unique visitors to their RTS 27 or RTS 28 sites. A range of firms stated that they have never received enquiries from their clients or from other market participants about the data that they publish.

3.37 The feedback therefore that we have received from different market participants is that the reports do not produce helpful inputs for assessing best execution or execution quality, or for choosing a venue or a firm to use for order execution. In most cases, market participants have found the RTS 27 reports overly complex and requiring significant analytical and IT resources to extract from different venues and to interpret. Wholesale market participants also note that the data in the reports are between 3 to 6 months old at the time of publication. This renders the reports irrelevant for firms to review their best execution decisions and venue selection.

3.38 Market participants providing services to retail and wholesale clients have indicated to us that the outputs from RTS 28 reports are equally unhelpful for scrutinising best execution and deciding on which brokers to use. Wholesale market clients are interested in information that is specific to the type and range of business they will be doing with a brokerage firm. Less interesting for them is generalised information which aggregates across business done with a disparate range of clients.

3.39 Instead of using the data from these reports, wholesale market participants typically use a range of other data to assess and scrutinise best execution. This includes:

- market data from aggregators and execution venues directly
- pricing data and analysis from brokers and liquidity providers directly as well as
- other internal and external data and analysis on pricing and transaction costs. Based on our conversations with market participants, we do not expect changes to the availability of RTS 27 or RTS 28 data to affect firms' use of other data

Proposals

3.40 We support the MiFID II objectives of increasing transparency and improving information about how firms execute and transmit their client orders and the outcomes that they obtain for their clients. However, we are concerned that RTS 27 and RTS 28 have not delivered on these objectives in a meaningful or effective way. The reports are not used by market participants, while at the same time they are costly for execution venues and firms to produce. As a result, we are proposing to delete these obligations.

3.41 We discussed with market participants possible changes to the formats of the reports. However, the discussions did not indicate it would be possible to revise the requirements to make them work significantly better than those in place. The main difficulty is that the most useful information to clients is information tailored to the specific business they undertake rather than more generic information. It seems there is no general approach based on aggregated data that will provide useful information for a sufficiently wide range of clients to make adequate use of them.

3.42 The rule changes we are proposing therefore involve deleting the UK versions of RTS 27 and RTS 28 and removing references to these obligations in the Handbook. The latter involves deletions in COBS 11.2A, 11.2B and 11.2C. Where reference is made to firms having to take account of data produced under RTS 27, this is replaced by a reference to them having to take account of relevant data or by other internal analyses. References to RTS 27 obligations for Multilateral Trading Facilities, Organised Trading Facilities and Systematic Internalisers in MAR 5, 5A and 6 are also being deleted.

3.43 We said in a statement on 19 March 2021 saying that we would not take action against firms who do not produce RTS 27 reports during 2021. We would expect to be able to take a final policy decision on whether to abolish these reports within that timeframe.

3.44 The FCA Handbook does not capture all the firms that currently have to produce RTS 27 and RTS 28 reports. For some firms, such as portfolio managers and firms who receive and transmit orders, the requirements are in secondary legislation in the UK MiFID delegated regulation. The Treasury is considering the case for proposing to Parliament changes to those provisions alongside the changes we are proposing in this consultation. Our proposed changes to the Handbook are dependent upon whether or not such changes occur.

3.45 We recognise that access to market data has remained a key concern among many market participants since MiFID II was introduced. Issues around it are much broader than RTS 27 and RTS 28, which market participants do not find usable. We have recently consulted on market participants' access to wholesale market data and are currently considering the feedback received. The Treasury intends to propose changes to those provisions of the delegated regulation. Our proposed Handbook changes take into account possible changes to the delegated regulation. We might need to revise these depending on the exact changes the Treasury may propose in due course and whether or not those changes become legislation.

Q8: a. **Do you agree with our proposal to remove the obligation for execution venues to produce execution quality reports consistent to the format prescribed under RTS 27?**

b. **If yes or no, please explain your views.**

Q9: a. **Do you agree with our proposal to remove the obligation for firms who execute orders to produce reports about their order routing and execution outcomes obtained consistent to the format prescribed under RTS 28? [Yes/No/No view]**

b. **If yes or no, please explain your views.**

4 Questions in this paper

Q1: a. **Do you agree with our proposal to create an exemption for SME research below £200m provided the research is offered on a rebundled basis or for free? [Yes/No/No view]**

b. **If yes or no, please explain your views.**

Q2: a. **Would you be likely to take advantage of the proposal to rebundle for SME research coverage? [Yes/No/No view]**

b. **If yes or no, please explain your views.**

Q3: a. **Do you agree that an Industry-led initiative to fund research would be capable of addressing low coverage of SMEs? [Yes/No/No view]**

b. **If yes, we would welcome your suggestions on how this can be developed.**

c. **If yes or no, please explain your views.**

Q4: a. **Do you agree with our proposal to create an exemption for FICC research? [Yes/No/No view]**

b. **If yes or no, please explain your views.**

Q5: a. **Do you agree with our proposal to include research provided by IRPs in the list of minor non-monetary benefits? [Yes/No/No view]**

b. **If yes or no, please explain your views.**

Q6: a. **Do you agree with the circumstances in which the exemption applies i.e. where the IRP is not engaged directly or indirectly in execution services? [Yes/No/No view]**

b. **If yes or no, please explain your views.**

Q7: a. **Do you agree with our proposal to include in the list of minor non-monetary benefits openly available written material? [Yes/No/No view]**

b. **If yes or no, please explain your views.**

Q8: **a.** **Do you agree with our proposal to remove the obligation for execution venues to produce execution quality reports consistent to the format prescribed under RTS 27? [Yes/No/No view]**

b. **b. If yes or no, please explain your views.**

Q9: **a.** **Do you agree with our proposal to remove the obligation for execution venues to produce execution quality reports consistent to the format prescribed under RTS 27? [Yes/No/No view]**

b. **b. If yes or no, please explain your views.**

Annex 1
Cost benefit analysis

Introduction

1. FSMA, as amended by the Financial Services Act 2012, requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'. This CBA comprises two sections: 1) research and 2) other proposals for change for wholesale and retail markets.

Section 1: research

2. In this section, we present the analysis and estimates of the impacts of our proposals on SME and FICC research. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. We have engaged with Industry Associations and individual firms to seek their views on the potential costs and benefits of the proposals. In the main, this provided us with qualitative rather than quantitative data, partly reflecting the optionality of the proposal for an exemption for SME research which has reduced Industry's confidence in projecting likely costs. When, in our opinion, these are not reasonably practicable to estimate, we provide a statement of our opinion and an explanation of it.

Problem and rationale for intervention

Harm and drivers of harm

3. FCA investment firms are an important element of a well-functioning economy. They help ensure capital is allocated efficiently and appropriately and help individuals make the most of their savings and investments whilst at the same time providing a source for companies seeking funding. A lack of information in the form of investment research for the buy-side may reduce informed demand for the affected instrument. It also reduces the efficiency of the price discovery process. In combination, this increases the costs of trading instruments, raises the cost of capital in the markets together resulting in a misallocation of capital and also leading to sub-optimal portfolio selection for investors thereby raising risk and lower returns.

4. Historically, firms typically 'bundled' research costs with transaction commissions (ie the cost of trading a share). However, MiFID II introduced requirements to set separate charges for transactions and research (thereby 'unbundling' these two services). Firms were required to either pay for research themselves from their own resources or agree a separate research charge with their clients.

5. The MiFID II requirements apply to research regardless of the market capitalisation size of the firm. This means that there is no differentiated treatment or exemption for SME research. There is a long-term decline in research coverage pre-dating MiFID II that is more pronounced for SMEs. For example, our analysis of coverage over a five-year period (see Figure 3, Chapter 3), has shown that the number of AIM-quoted companies with no research coverage has increased post-MiFID II, from around 40% to around 44%. This has the consequence that post-MiFID II, the harm from reduced coverage for firms in this segment of the market may be greater than for larger firms who have several analysts providing coverage compared to many SME firms that may have only a few or no analysts providing coverage.

6. MiFID II also imposed costs on both the buy-side and the sell-side for all research in becoming compliant with the new regime. Increasing the costs for fund managers to access research, can compound the effects from the long-term decline in the level of equity research, especially SME research. For example, our analysis of public companies with market caps below £250m show that, there are large numbers of companies (79%) with no research coverage or are covered by a sole analyst (see Figure 2, Chapter 3). This reduction in equity research results in the harm described above.

7. The MiFID II inducements requirements on separate pricing also applied to research on fixed income. This departed from the historical position where dealers in FICC markets have provided research for free to asset managers with which they transact. Prior to MiFID II, payment for FICC transactions to the broker was typically paid for from the gap between the bid and ask prices of an instrument or 'spread'. Some stakeholders have suggested the application of the MiFID II inducement rules to FICC research has resulted in additional costs for firms in the form of monitoring contracts, budgetary and research evaluation operations rather than a reduction in the volume of FICC research produced or consumed. The harm directly arises from the compliance costs that do not deliver significant benefits to investors in FICC but also the harm that arises from less information and research in FICC.

Summary of our proposed intervention

8. Our proposals are set out in detail in the CP. These comprise the following:

- An exemption from the inducement rules for research on listed or unlisted SMEs companies who have a market capitalisation below £200m provided it is offered on a rebundled basis or for free.
- An exemption from the inducement rules for third party research received in connection with investment strategies that relate primarily to fixed income currencies and commodities (FICC) instruments.
- An exemption from the inducement rules for research received by independent research providers where this does not involve execution.
- An exemption from the inducement rules for openly available written material.

Figure 1: the causal chain – SME research

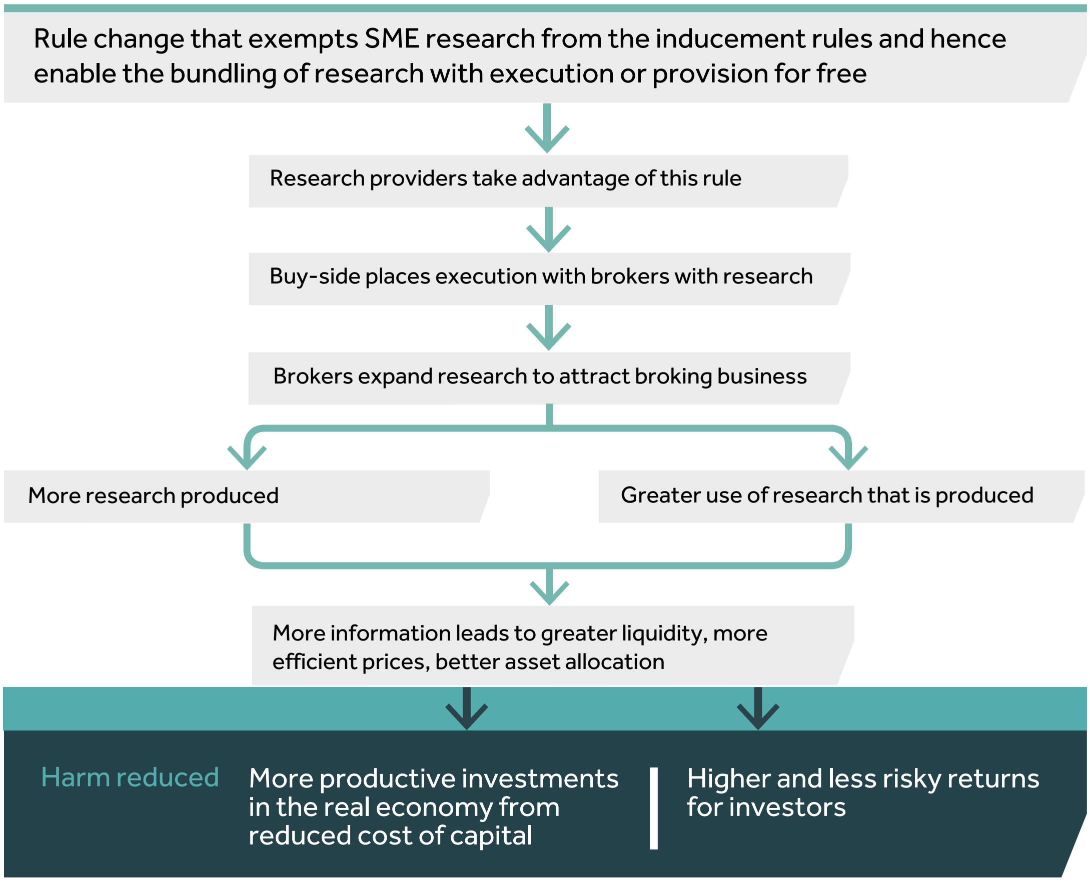
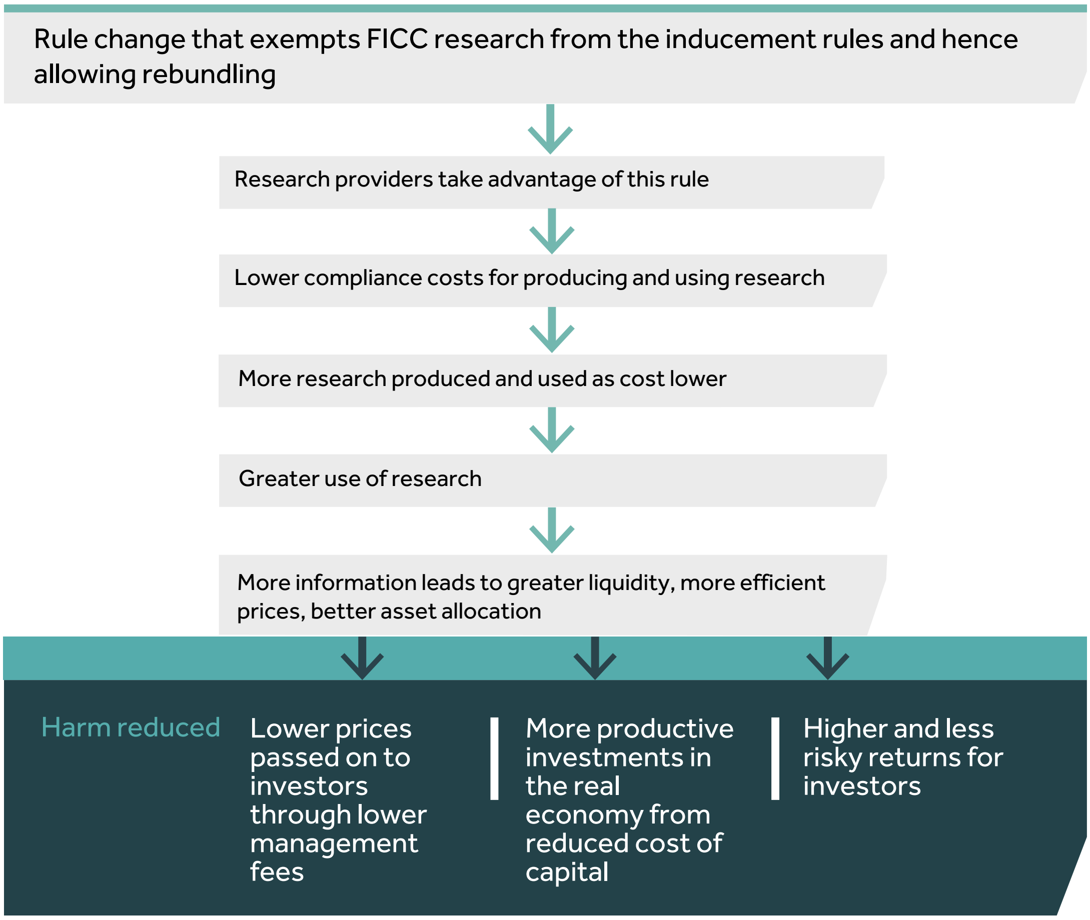


Figure 2: the causal chain – FICC research



Baseline and key assumptions

9. The CBA is a statement of the differences between the baseline (which we usually consider to be the current position) and the position that will arise if we implement the proposals. The costs and benefits of the proposals arose from the difference in these scenarios.

10. MiFID II banned the receipt of all monetary and non-monetary benefits by portfolio managers in relation to their services to clients, other than minor non-monetary benefits and except for third party research provided it is paid from either:

- A firm's own resources
- A separate research payment account (RPA)

11. Our analysis shows decline in research on SME instruments pre-dates MiFID II (see Figure 1, Chapter 3). This decline is likely to be exacerbated by a move to passive investment. We expect that research overall continues to decline, albeit with falls in analysts being focused in large cap firms and current increase in numbers of firms without any research from 40% to 44% over a 5-year period. In our baseline, we expect this trend will continue in the future but it is likely that the trend will flatten out over time as the research that remains is profitable for providers to create.

12. In contrast, because of the classification of FICC research at times includes other research, such as macroeconomic research, it has not been possible to calculate the impacts of MiFID II on supply and demand of FICC research.

Summary of costs and benefits

13. We have estimated some of the costs and benefits of our proposals. However, it is not reasonably practical to quantify all the costs and benefits of our proposals. In the case of our proposals for research from IRPs and openly available written material, we do not anticipate there will be significant costs.

14. The following table sets out the costs and benefits we describe in this CBA.

Firm type	Costs	Benefits
Asset managers	Familiarisation costs and legal review cost – £70k one-off Systems, process and IT costs – £7.5-22.5m one-off and £1.8-5.3m per year ongoing	Lower compliance costs for FICC – £2.5-6.7m per year ongoing Lower compliance costs for guidance on IRP and publicly available research – not quantified Reduction in costs of buyside research – not quantified
Research providers and brokerage firms	Familiarisation costs – £20k Systems, process and IT costs – £3-6m one-off and £0.7-1.4m ongoing Increased costs of producing research – £1.4-2.8m one-off and £0.8-2.6m per year ongoing	Lower FICC compliance costs -£0.7-1.4m per year ongoing
Investors	Loss of best execution – not quantified Cost associated with more trading activity – not quantified Greater payment towards research – not quantified	Increased liquidity lower cost of trading – £1.9-3.8m per year ongoing Increased market efficiency – not quantified
Wider economy		Lower primary issuance costs- £4.0-8.1m per year ongoing Increase in investment from lower issuance costs – not quantified

15. Although, we are unable to estimate all the costs and benefits, we present the total estimated costs and benefits for each element for the costs and benefits we have estimated.

- For SME research, we estimate total one-off costs of £6.7-17.1m and ongoing costs of £3.3-9.3m and ongoing benefits of £6.0-11.9m.
- For FICC research, we estimate total one-off costs of £5.3-14.3m and ongoing benefits of £2.5-6.7m

16. A key consideration to assessing the overall proportionality of our proposals depends on the extent to which firms on the buy and the sell-side choose to use the options provided by our proposals. Further, even where firms chose to avail themselves of the options, it is difficult to predict how much research output may change. However, for the proposed exemption for FICC research, we would expect that firms utilising this option would benefit from ongoing compliance cost savings that would quickly start

to exceed the initial costs of changing systems to implement them. We also expect that the compliance cost savings, although reasonably small, would outweigh the costs that may arise. For SME research, the proportionality is more balanced. The size of the costs and benefits are more uncertain and dependent on how the market responds. This is because the increase in research (and the benefits that arise) is dependent on the number of firms that take up the SME exemption. The costs of using the exemption are also dependent on firm take-up. The costs and benefits we have estimated suggest that the proposal will be net-beneficial but as we are unable to estimate all the costs and benefits from our proposal there is an element of judgement inherent in our assessment of proportionality.

Costs

17. In the sections below, we have assessed the costs arising from the rule changes.

18. There are up to 200 authorised fund managers firms who manage assets who may be affected by our proposals. The effect on each of these firms depends on their response to our proposed rule changes.

19. There are also around 50 research providers active in the UK. Some of these firms are independent research providers with the remainder providing research alongside other services to the buy-side such as execution.

Familiarisation costs

20. We expect that firms will incur costs from familiarising themselves with the remedies we are proposing.

21. In total, we expect there are up to around 240 firms who will likely seek to understand our package of the proposals. We are using our standard approach to estimating familiarisation costs. We anticipate that there will be approximately 14 pages of policy documentation with which firms will need to familiarise themselves. Assuming that there are 300 words per page and a reading speed of 100 words per minute, it would take around 36 minutes to read the policy documentation. It is further assumed that 20 compliance staff at large firms and 5 compliance staff at medium firms and 2 at small firms read the document. Finally, using data on salaries from the Willis Towers Watson UK Financial Services survey, the hourly compliance staff salary is assumed to be £59 at large groups, £63 and £45 at small firms, including 30% overheads. Using these assumptions, we expect total one-off industry-wide costs of familiarisation of approximately £55k.

22. We also expect those affected will undertake a legal review of the new requirements against current practices. We, again, use standard assumptions to estimate these costs. There are around 3 pages of legal instrument to review. It is assumed that there are 4 legal staff at the largest firms, 3 at medium firms and 2 legal staff at small firms, will review the legal instrument. It is further assumed that each legal staff member will review 50 pages of legal text in 4 days at large firms, 3 days at medium firms and 1 days at small firms. Finally, using data on salaries from the Willis Towers Watson UK Financial Services survey the hourly legal staff salary is assumed to be £69 at large firms, £69 at medium firms and £55 at small firms, including 30% overheads.

23. The estimated total one-off legal review costs are around £35k.

24. In total, the familiarisation and legal review costs are £90k.

Systems, process and IT costs

25. For the proposed SME exemption options, we would expect that where buy-side firms decide to take advantage of the rules they will incur costs from setting up and maintaining systems to ensure that only SME research can benefit from the exclusion. For example, firms will need to check that research benefits from the exemption from the inducement rules. There are additional costs from operating the two sets of pricing and payment arrangements that will be required when splitting out the exemption for SME research from the broader procurement process.

26. In consultation with industry about our proposals, we received very limited feedback on costs with only one large buy-side firm able to provide us with indicative costs information that they would incur £150k of one-off costs from rebundling SME research and have ongoing costs of £70,000 per year.

27. To provide a check on whether it is reasonable to use this estimate of the costs for the wider industry, we used an alternative methodology to estimates the costs. We estimated one-off costs using data we have collected on the time taken to undertake other projects within regulated firms. Using such an approach, we estimate that the number of single person days to adjust systems would be 546 for a large firm and 156 for a medium and small firms and 50 days of person time to implement the change (across various business types). This estimate for days may be reduced according to the number of persons that a firm dedicates to making any necessary adjustments. This implies a cost of £213k for large firms, £59k for medium firms and £44k for small firms using data on salaries. This is broadly in line with the costs reported by the firm in feedback. We therefore believe that the firm's costs are a reasonable estimate of the likely wider costs of maintaining a dual system approach to research. We therefore used the estimate from the firm in this CBA.

28. The overall costs of the changes depend on the number of firms that take advantage of our proposals. Not all buy-side firms will choose to take up the option provided by our proposals. For example, investment firms that source research for mixed portfolio clients, covering firms of different market capitalisations, may incur greater costs in utilising the SME exemption that outweigh the benefits of rebundling. This is because SME research may only form a small part of their investment portfolio and they may not be willing to cover the research costs. More generally, there may be competitive implications for firms choosing to exercise an option to rebundle if clients favour the existing status quo of payment from own P&L over any benefits from potentially increased research that may be offset by requiring their own payment.More generally, there may be competitive implications for firms choosing to exercise an option to rebundle if clients favour the existing status quo of payment from own P&L over any benefits from potentially increased research that may be offset by requiring their own payment.

29. Based on our discussions with Industry we think it is reasonable to assume that between 25-75 buy-side firms take advantage of the proposals. We estimate the total one-off costs for buy-side firms to be £3.8-11.3m and the ongoing costs to be £1.8-5.3m.

30. Based on our discussions with Industry we think it is reasonable to assume that on the sell-side, we would expect firms to incur costs initially from changing and removing process for SME research. If we assume that 10-20 sell-side firms incur these costs then the total overall systems, process and IT costs for the SME proposals are £1.5-3.0m one-off and £0.7m-1.4m per year on an ongoing basis.

31. For the FICC proposals, we expect that firms will incur costs in changing systems and processes so that the inducement rules are not applied to them. Once they have done so, firms will benefit from compliance cost savings as they no longer have to comply with the inducement rules for FICC. Based on our discussions with Industry, we might expect similar one-off costs as the SME research proposals but anticipate greater take-up of between 30-85 buy-side firms. We therefore estimate that there will be one-off costs of around £5.3-14.3m.

32. In total, we expect total one-off systems, process and IT costs of around £10.5-28.5m and ongoing system and process costs of £2.5-6.7m per year.

Loss of best execution

33. Our proposals on SME research will provide incentives for fund managers to direct trades to those providing research, rather than the provider that gives best execution. This will potentially lead to an increase in the execution costs from trading these assets for investors.

34. It is not reasonably practicable to estimate the costs to investors from any reduction in best execution. This is because it is not possible to assess the extent to which fund managers might direct trades to different providers as a result of the desire to obtain research. Neither do we know how the extent of any redirection of execution activity will affect the level of execution costs. In many instances, there may not be a difference or the difference may be negligible.

Increased costs of research

35. Increasing the coverage of research will entail more resources being used to create this research.

36. The average cost of initiating coverage of an SME firm/instrument and the average ongoing costs of covering an SME firm/instrument is likely to vary. This is likely to be reflective of a firm's willingness to devote analyst time to a smaller listed company, which may in turn be dictated in part by the number of analysts at a firm and the need to be balance this relative to any reduced time spent on a larger more established company. We have received various estimates from firms and industry association on the cost of research. The actual cost will depend on factors including the complexity of the SME business model. Based on limited quantitative feedback from Industry estimate that there is a one-off starting cost of £15-30k and an ongoing cost of £9-28k.

37. It is difficult to predict how our proposals will affect research coverage, but we assume that the decline in coverage over the year from June 2017 to June 2018 is reversed. We chose this time period to capture the time when we would likely see the impact of the introduction of inducement rules in MiFID II. Over this period, there was a large increase in the number of firms without coverage. For our estimation, we assume that there is a 22% increase in the number of analysts in the AIM market. However, given the impact of our proposals is highly uncertain, we also estimate the impact for half this effect.

38. This implies a one-off cost from starting additional research of £1.4-2.8m and an ongoing cost of £0.8-2.6m per year.

39. We have not estimated the additional cost of the increased amount of FICC research produced under our proposals. We do not think it is reasonably practicable to do so as measuring research is less straightforward (rather than measuring coverage per firm) and therefore it not possible to provide an overall estimate of the additional cost of coverage.

More trading activity

40. Greater amounts of research activity will result in more trading activity in the instruments affected by our proposals. There are various reasons why this might be the case. Fund managers have an incentive to trade more to gain access to research that is provided with execution services. A wider set of liquid assets will likely increase the amount of trading undertaken.

41. There are costs associated with this increase in trading activity. It is not reasonably practicable to estimate how much trading may increase under our proposals. This is because it is not possible to predict how market dynamics may change under our proposals. However, we would expect that any increase in total trading costs will be proportionate to the benefits we describe below.

Benefits

Lower compliance costs

42. There will be a compliance costs saving from our proposals to exempt FICC Research from the inducement and conflicts of interest rules.

43. We received very limited feedback quantifying costs from engagement with Industry Associations and individual firms. As part of this, one very large firm on the sell side told us that that the costs of compliance with the MiFID II research unbundling regime for FICC research is approximately $1-1.25 million per annum, of which the most significant portion of this is technology and processing costs. This is around £700-900k at current exchange rates. Additionally, this refers to their overall compliance costs rather than the costs only incurred under UK regulated activity. This is likely to be the upper bound of savings for firms on sell-side.

44. We would expect that the savings on the buy-side are at least as big as on the sell side. This is because the inducement rules are more onerous for the buy-side. We assume that there will be ongoing compliance cost savings for FICC. Hence, firms on the buy and sell-side save £2.5-6.7m per year on systems and process savings from not having to apply the inducements and conflicts rules to FICC.

45. Additionally, we expect that there will be smaller compliance cost reductions from our guidance around generally publicly available research. This is because some firms will be applying the inducements rules to these products.

Impact on competition

46. Prior to MiFID II, it was common for asset managers to receive execution services and additional goods and services, predominately research, from their broker in return for dealing commissions. The terms on which additional services were provided were not always explicitly agreed, and there was an implicit understanding that asset managers would reward their broker with dealing commissions in exchange for those additional services.

47. This practice of 'bundling' raised several competition concerns. Bundling services together reduced price transparency, as asset managers may not have been clear on how much they paid for research on its own. Bundling created inducements to trade, whereby asset managers may have sent trades to brokers who provide them with additional services rather than brokers who would have provided the best execution services. Bundling resulted in a misalignment of principal-agent incentives as transaction costs were not included in the headline fund management figure so asset managers were less incentivised to control for these costs. Finally, bundling could lead to an overproduction and overconsumption of research, as asset managers face little marginal cost with respect to the consumption of research. As part of MiFID II, brokers were required to unbundle the fees for trade execution and research to reduce the impact of these distortions to competition.

48. Our analysis indicates that unbundling fees has enhanced price transparency and removed inducements to trade, including addressing the misalignment of incentives between principals and agents. It has led to increased use of counterparties by investment managers for execution-only services and reduced use of brokers for research and execution, indicating use of lower cost channels to achieve cost savings for clients.

49. Given the current lack of research for SMEs, the provision of an exemption may result in pro-competitive outcomes in the provision of SME research and brokerage. At present there is a lack of SME research. Allowing research to be provided without an explicit charge will remove a current restriction preventing SME brokers from giving free research to their clients. SME brokers who provide free or bundled research to investment managers may expect to be rewarded for their research by receiving more trades thereby increasing their trading commissions. Consumption of research may also increase investor demand for investments in SMEs, which generates further increases in trading commissions. This would potentially make the provision of SME research more profitable for brokers and stimulate an increase in the production of SME research. Higher profitability could incentivise further firm entry in SME research and promote competition between SME brokers.

50. There is a potential risk that the proposal results in inducements to trade, pushing trading to brokers offering both execution and research rather than just execution. This effect is most likely to impact SME research providers who do not provide broking services. It may also weaken the selection of research providers guided by price, reducing incentives for asset managers to cut costs. However, given the low levels of existing and historic levels of research and trading for companies of this size, we do not anticipate that the effects are likely to be dramatic.

51. Similarly, there is a risk that the proposal may distort price transparency for SME research, as investors may find it more difficult to evaluate the price of research which is free or bundled with independent research. However, price transparency in SME research may not be effective due to weak supply and demand. Asset managers may be reluctant to pay for SME research due to rationalisation of spending and potential weaker returns due to poor liquidity. As a result of insufficient research, there is little for investors to compare between which leads to inefficient price formation in SME research. Further, while the loss of price transparency may have a negative impact on competition in SME research, the potential increase in research as a result of bundling may lead to larger positive impacts, such as improved research coverage and higher levels of investment. Therefore, we do not anticipate that the potential effects from less price transparency are likely to be dramatic nor outweigh the benefits of bundling.

52. An increase in research availability and wider distribution of research should increase interest in investments in small and mid-caps below the proposed threshold of £200 million, stimulating demand for these stocks. This will likely improve liquidity in small and mid-caps, which could further stimulate demand from investors. Higher levels of investor interest and competition between asset managers for SME investments is likely to lead to more efficient price formation, lower levels of volatility and, thus, a lower cost of capital for SMEs.

53. We would not expect our proposals to affect competition between asset managers. Rebundling may make pricing more complicated for investors to assess, especially as any price changes are likely to be passed onto investors in the form of execution costs for SME investments. However, asset managers have indicated they can still get the research they need despite smaller budgets, which implies market efficiencies such as a better ability to assess the research they require. Asset managers are not incentivised to lower their net returns to purchase SME research they do not require. Lastly, the exemption will apply equally to all asset managers in the UK therefore we do not consider there will be competition effects.

54. Overall, our competition analysis of the proposed exemption suggests positive impacts. These arise from improved research coverage and the potential increase in asset manager interest and liquidity will be concentrated on the firms who would benefit most from the proposal. We note that these pro-competitive outcomes may not arise in markets where there are already adequate levels of research and may in fact lead to anti-competitive outcomes. Given these firms do not have any research coverage, the potential risks for clients of assets managers from inducement to trade due to provision of free or bundled research and a lack of control of costs is likely to be outweighed by the positive impacts from improved transparency/research in SME markets, liquidity and economic benefits from easier access to capital for SMEs.

Impact on liquidity

55. More research on SME instruments will lead to more information about SMEs being available in the market. We expect that this increase in information will increase liquidity and hence lower trading costs.

56. We use the results of research on the impact of increases in analyst to estimate the relationship between analyst coverage and liquidity (see Roulstone, Darren T. "Analyst Following and Market Liquidity." Contemporary Accounting Research 20, no. 3 (2003): 552–78.). This research found that a 10% increase in the number of analysts results in a 4% decrease in the spread. The median number of analysts in their sample is 15 so a 5% increase is approximately 1 analyst. This implies that additional coverage by 1 analyst leads to a 2% decrease in spread.

57. Our proposals will mostly affect AIM as this is where the majority of companies affected by our SME proposal are listed, and also where we see significant numbers of firms without research coverage. In 2020, the total value of AIM trading on the LSE was £69bn. The market capitalisation weighted average spread of trading in ASIM stocks is around 1.26%.[2] This implies an overall cost of trading of £870m per year.

58. We, again, use our estimate of a 22% increase in the number of analysts. However, we note that it is far from certain that the observed trend in coverage will be reversed for these proposals. We also therefore assume an increase in analysts of half the observed trend.

59. Bringing these estimates together, we estimate that there is a £1.9-3.8m reduction in trading costs from our SME proposals.

60. Greater FICC research will also lead to greater levels of liquidity. We do not believe that it is reasonably practicable to estimate the benefits from greater liquidity in FICC markets as the information and research available on these markets is less than in equity markets.

Impact on primary issuance costs

61. Increased information about a security increases the ability for markets to accurately value securities as it reduces the information asymmetry facing investors. Consequently, greater amounts of research on issuing securities will lower primary issuance costs. Lower costs of finance have a positive effect on the amount of investment in the real economy.

62. To estimate these primary issuance benefits, we apply the findings from research on the relationship between research coverage and the cost of primary issuance (see Bowen, Robert M., Xia Chen, and Qiang Cheng. "Analyst Coverage and the Cost of Raising Equity Capital: Evidence from Underpricing of Seasoned Equity Offerings*." Contemporary Accounting Research 25, no. 3 (2008)). This research found that firms, with the median level of analyst coverage in their sample being three analysts, have a 1.19% lower seasoned equity offering underpricing, compared to firms without coverage. Assuming a linear relationship, this implies that gaining coverage by 1 analyst will see a reduction in issuance costs of 0.4%.

63. In 2020, the total value of issuances of UK listed equities below £200m was £2.0bn.

64. Combining these figures, and again assuming also that we only observe half the effect that we estimate using the above figures to create a more conservative estimate, we estimate that there is a reduction in issuance costs from the SME proposals of £4.0-8.1m per annum.

Impact on market efficiency

65. Under our proposals we expect to see an increase in the amount of research produced on SME research and FICC as a consequence of the cost of producing research having reduced. Increased information about securities increases the markets ability to accurately value securities and makes prices more reflective of the affected asset's fundamental value. Prices are an important signal for the allocation of resources in the real economy. More persistent mispricing leads to poorer asset allocation.

2 Taken from daily spreads as at the 3rd of March 2021 from Refinitiv Eikon.

66. We do not think it is reasonably practicable to estimate the benefits from capital allocation as result of the improvements in market efficiency. There are many ways in which the performance of markets affects behaviour in the real economy. We do not think it is reasonably practicable to assess how changes in market efficiency from our proposals would affect behaviour in the real economy.

Reduction in the cost of producing buy-side research

67. Under our proposals, we would expect that there is an increase in the amount of research produced by the sell-side. In response to this, we would expect the buy-side to reduce the amount of research and analysis undertaken in house. We have already estimated the cost on the sell-side from an increase in the amount of research produced. We expect that research produced in-house on the buy-side is a substitute for that produced by the sell-side. Therefore, we would expect more sell-side research would lead to a reduction in the amount of buy-side research produced and therefore the costs incurred in creating this research.

68. We do not think it is reasonably practicable to estimate this reduction in buy-side research. This is because we do not think it possible to assess how the amount of research within the buyside would be affected by changes in the amount of research produced by the sell-side.

Q10: Do you have any comments on our cost benefit analysis on our research proposals?

Section 2: Best Execution reporting requirements under RTS 27 and RTS 28

69. Our analysis and engagement with market participants have identified that RTS 27 and 28 reporting obligations for execution venues and investment firms are costly to produce and the intended benefits of improving investor protection and transparency over execution quality have not materialised. Industry feedback has indicated that these reports are not read by their intended audiences nor regarded as useful to assess best execution. Wholesale market participants typically use other data, such as direct data feeds from exchanges, data from aggregators such as Bloomberg or Reuters, data from brokers and liquidity providers or internal data and analysis to do this instead. Our work has also not identified retail consumers using the data. Venues and firms have told us that the reports are burdensome and costly to produce. The key driver of harm is regulatory failure: these requirements, in our view, impose harm in the form of compliance costs on firms that do not bring in much, if any benefits.

Summary of our proposed intervention

70. Our proposals will remove the reporting obligations in RTS 27 and 28 outlined above and in Chapter 3 of the CP.

71. Revoking the requirements means that execution venues will no longer have to make public detailed quality of execution metrics and that investment firms can turn off their annual reporting for the top-5 execution venues used. We expect this to result in cost savings for venues and firms and increased efficiency.

72. The causal chain below outlines how we envisage the proposal will reduce harm.

Causal chain

FCA removes RTS 27 and 28 reporting requirements

↓

Firms are aware of the changes and make the necessary changes

↓

Firms no longer undertake RTS 27 and RTS 28 reporting reducing compliance costs

↓

Clients of execution venues and investment firms may benefit in savings passed on in the form of lower fees and charges

↓

Harm reduced — Better client experience and time saved, lower costs to firms, passed on to consumers in the form of lower prices

Baseline and key assumptions

73. In March, we issued a statement setting out that we will not take action against firms who do not report under RTS 27 for the remainder of 2021. The baseline assumption that we have used in the cost benefit analysis is that without making the Handbook changes, firms will need to continue to report under RTS 27 after the end of the year and under RTS 28 as they currently do. The harm to firms and clients would therefore stay at the level seen immediately before our March statement.

74. It is worth noting that while the FCA is preparing changes to the UK requirements, the European Union has also set forth its Quick fix changes on the areas that we are consulting on, that Member States will implement in February 2022. These changes may have an impact on the estimated costs and benefits of our proposals. If the EU revisits its suspension of the above requirements, firms that carry out business activities in both the UK and the EU would have to incur the fixed costs in relation to the reporting requirements. This would reduce the benefits of our intervention. Our baseline assumption, however, is that EU Quick fix changes will be permanent.

Number of firms

75. We assume that our proposals will impact all investment firms authorised by the FCA to provide or perform MiFID investment services or activities. As of March 2021, there are 3,326 firms with this authorisation. Of these, there are up to 300 execution venues who currently have to comply with the RTS 27 requirement. RTS 28 applies more widely and the total number of MiFID firms is a better proxy for its applicability, although there will be some, such as venue operators and proprietary trading firms, to whom it does not apply.

76. We determine firm size based on the fees that firms pay – out of all regulated firms, the 250 firms paying the highest fees are classed as large, firms from 251 to 1750 are classified as medium, and all the rest as small. In our sample, 55 are large, 418 medium and 2,853 are small.

Summary of costs and benefits

77. The table below summarises the costs and benefits to firms and customers.

78. Through our engagement with Industry we received some cost savings estimates for these interventions. Based on this engagement we believe the ongoing costs savings and benefits more than make up for the estimated costs. However, we received a limited number of responses and these may not necessarily be representative of the market. In addition, in some instances, responses were qualitative rather than quantitative. As a result, we are unable to fully estimate the potential cost savings for firms of these changes. Where possible we have sought to make reasonable estimates of likely impact using the standardised cost model.

Stakeholder	One-off/ongoing	Costs	Benefits
Firms	One-off	Familiarisation and legal costs – £0.8m	
	Ongoing		Reduced operating costs
Customers	Ongoing		Some of the cost savings for firms could also be translated into savings for clients
Total	One-off	£0.8m	
	Ongoing	N/A	

Costs

Costs to customers

79. The potential costs arise from market participants and consumers having to obtain and purchase other information to scrutinise best execution that they would otherwise not have obtained if venues and investment firms continued to report under RTS 27 and RTS 28. Our conversations with intended users of the reports ranging from asset managers to retail and sell-side brokers and consumers indicate that there will be no change to the information market participants will consume to scrutinise best execution as a result of our intervention.

80. Wholesale market participants typically told us that they use other data, such as transaction cost analysis, internal pricing and transaction data and models, and data received from brokers, counterparties and trading venues directly to scrutinise best execution. As these market participants don't currently use the RTS 27 or RTS 28 data, their expenditure to other data and information will remain unchanged regardless of our proposals.

Costs to firms

81. We do not expect there to be material costs that firms would have to incur as a result of our proposals. There will be some costs arising from firms having to familiarise themselves with the abolishment of the requirements and switching off their systems to produce the reports. We do not expect firms to incur any indirect costs or any ongoing costs.

82. We are using our Standardised Cost Model (SCM) to estimate costs.

Familiarisation and legal costs

83. We use standard assumptions to estimate one-off familiarisation costs. We anticipate that there will be approximately 9 pages of policy documentation, excluding the legal instruments. Assuming 300 words per page and a reading speed of 100 words per minute, it would take around 0.5 hours to read the document. We assume the number of staff that read the document is 20 in large firms, 5 in medium and 2 in small. The hourly compliance staff salary assumption is based on the Willis Towers Watson 2016 Financial Services Report, adjusted for subsequent annual wage inflation and including 30% overheads. We estimate the total familiarisation cost to be £205,468.

84. For legal costs, we assume 11 pages of legal text. We anticipate that 4, 2 and 1 legal staff will read the legal instruments in large, medium and small firms respectively, each staff member taking 12 hours. Basing the legal staff salary on the Willis Towers Watson 2016 Financial Services Report, we calculate legal costs of £602,000.

85. The total one-off familiarisation and legal cost is estimated at £0.8m.

Benefits

Benefits to Customers

86. It is possible that some of the cost savings that execution venues and investment firms can create as a result of our proposals could translate into benefits to clients. This could take the form of lower fees and charges by firms or improved pricing offered by market makers and other liquidity providers who currently produce RTS 27 reports. However, it was not reasonably practicable to estimate these benefits due to data limitations.

Benefits to firms

87. Generally, firms will benefit from our proposals in the form of cost savings and increased efficiency from removal of reporting requirements. Our industry engagement indicates that for the RTS 27/28 changes some firms will save between £6k to £150k per annum. However, we received a limited number of responses and we are uncertain how representative of the market these figures are. Based on information from market participants, cost savings will primarily arise from staff and management time spent on reviewing, validating and signing off disclosures and reports, as well as maintaining the systems to compile data and data storage. Overall, we consider the proposal will remove the harm caused by the regulatory failure and the benefits will outweigh costs. However, it was not reasonably practicable to estimate these benefits due to the limited quantitative costs information we received from our industry engagement.

Q11: Do you have any comments on our cost benefit analysis?

Annex 2
Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

2. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty, under s. 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, and (b) its general duty under s. 1B(5)(a) FSMA to have regard to the regulatory principles in s. 3B FSMA. The FCA is also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

3. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

4. In addition, this Annex explains how we have considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.

5. This Annex includes our assessment of the equality and diversity implications of these proposals.

6. Under the Legislative and Regulatory Reform Act 2006 (LRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRA.

The FCA's objectives and regulatory principles: Compatibility statement

7. We consider the proposals in this consultation are compatible with the FCA's strategic objective of ensuring that the relevant markets function well. The proposals are seeking to maintain high standards of consumer protection whilst reducing compliance burdens on firms and to make the market for research for smaller companies, which does not currently work well, work more effectively. For the purposes of the FCA's strategic objective, "relevant markets" are defined by s. 1F of FSMA.

8. The proposals set out in this consultation are primarily intended to advance the FCA's operational objective of securing an appropriate degree of protection for consumers. The proposals will help achieve this by ensuring our rules more fully reflect differences in the knowledge and experience of different types of clients, better reflect the ways in which clients interact with firms providing them with investment services and tailor rules on research to the circumstances in which the provision of research is most likely to be associated with poorer outcomes for consumers.

9. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA. The need to use our resources in the most efficient and economic way.

10. Our proposals are designed to be as proportionate as possible relative to risk and ensure that firms and clients have clarity about our expectations.

The principle that a burden or restriction should be proportionate to the benefits

11. The CBA in Annex 2 sets out the costs and benefits of the proposals in this CP. We believe that the benefits of these proposals outweigh the costs.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

12. We have had regard to this principle including the government's aim of seeing more competition and innovation in all sectors of the UK financial industry and consider that our proposals on research for smaller companies support it.

The general principle that consumers should take responsibility for their decisions

13. We have had regard to this principle including consideration of proportionate requirements on reporting and disclosure according to the level of knowledge and experience of different types of clients.

The responsibilities of senior management

14. We have had regard to this principle and do not consider that our proposals undermine it.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

15. We consider that our proposals do not undermine this principle.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

16. This principle is not relevant to our proposals.

The principle that we should exercise of our functions as transparently as possible

17. We believe that by consulting on our proposals we are acting in accordance with this principle. We have also spoken to a wide range of firms and other stakeholders in formulating these proposals.

18. We do not regard our proposals as being relevant to the need for the FCA to have regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s. 1B(5)(b) FSMA).

Expected effect on mutual societies

19. The FCA does expect the proposals in this paper to have a significantly different impact on mutual societies. The relevant rules we propose to amend will apply, according to the powers exercised and to whom they are addressed, equally regardless of whether it is a mutual society or another authorised body.

Compatibility with the duty to promote effective competition in the interests of consumers

20. In preparing the proposals as set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers. Competition issues are discussed in our analysis of our proposals on research.

Equality and diversity

21. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.

22. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in paragraph 2.16-2.17 of the Consultation Paper.

Legislative and Regulatory Reform Act 2006 (LRRA)

23. We have had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance. We have clearly set out our proposed rule changes in a transparent way and been clear that our proposals will only be fully effective if changes are also made to legislation. In part the changes we are proposing are intended to ensure that our requirements are more proportionate and better tailored to business done with different types of client.

24. We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance and consider that our proposals are consistent with the Code including that all elements of guidance being proposed alongside new rules are designed to contribute to clarity of understanding and interpretation of our proposed new Handbook provisions.

Annex 3
Abbreviations used in this paper

Abbreviation	Description
CBA	Costs benefit Analysis
COBS	Conduct of Business sourcebook
Commission	European Commission
CP	Consultation paper
ECP	Eligible Counterparty
EU	European Union
FCA	Financial Conduct Authority
FICC	Fixed Income Currencies and Commodities
FSMA	Financial Services and Markets Act 2000
IRP	Independent Research Provider
MiFID	Markets in Financial Instruments Directive
MiFID II	Markets in Financial Instruments Directive II (includes MiFIR, where the context indicates)
RPA	Research Payment Account
SME	Small and Medium-sized Enterprise
UK	United Kingdom

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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Appendix 1
Draft Handbook text

CONDUCT OF BUSINESS SOURCEBOOK (AMENDMENT) INSTRUMENT 2021

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the powers and related provisions in or under:

(1) the following sections of the Financial Services and Markets Act 2000 ("the Act"):

(a) section 137A (The FCA's general rule-making power);
(b) section 137T (General supplementary powers);
(c) section 139A (Power of the FCA to guide guidance); and

(2) regulation 3 of the Financial Regulators' Powers (Technical Standards etc) (Amendment etc) (EU Exit) Regulations 2018; and

(3) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions sourcebook (GEN) of the FCA's Handbook.

B. The rule-making provisions referred to above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*].

Amendments to the Handbook

D. The modules of the FCA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Conduct of Business sourcebook (COBS)	Annex A
Market Conduct sourcebook (MAR)	Annex B
Recognised Investment Exchanges sourcebook (REC)	Annex C

Citation

E. This instrument may be cited as the Conduct of Business Sourcebook (Amendment) Instrument 2021.

By order of the Board
[*date*]

Annex A

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

2 Conduct of business obligations

…

2.3A Inducements relating to MiFID, equivalent third country or optional exemption business and insurance-based investment products

…

Acceptable minor non-monetary benefits

2.3A.19 R An acceptable minor non-monetary benefit is one which:

(1) is clearly disclosed prior to the provision of the relevant service to the *client*, which the *firm* may describe in a generic way (where applicable, in accordance with *COBS* 2.3A.10R);

(2) is capable of enhancing the quality of service provided to the *client*;

(3) is of a scale and nature that it could not be judged to impair the *firm's* compliance with its duty to act honestly, fairly and professionally in the best interests of the *client*;

(4) is reasonable, proportionate and of a scale that is unlikely to influence the *firm's* behaviour in any way that is detrimental to the interests of the relevant *client*; and

(5) consists of:

(a) information or documentation relating to a *financial instrument* or an *investment service*, that is generic in nature or personalised to reflect the circumstances of an individual *client*;

(b) written material from a third party that is commissioned and paid for by a corporate *issuer* or potential *issuer* to promote a new issuance by the company, or where the third party *firm* is contractually engaged and paid by the *issuer* to produce such material on an ongoing basis, provided that the relationship is clearly disclosed in the material and that the material is made available at the same time to any *firms* wishing to receive it, or to the general public;

(c) participation in conferences, seminars and other training events on the benefits and features of a specific *financial instrument* or an *investment service*;

(d) hospitality of a reasonable de minimis value, such as food and drink during a business meeting or a conference, seminar or other training events mentioned under paragraph (c);

(e) research relating to an issue of *shares*, *debentures*, *warrants* or *certificates representing certain securities* by an *issuer*, which is:

(i) produced:

(A) prior to the issue being completed; and

(B) by a *person* that is providing underwriting or placing services to the *issuer* on that issue; and

(ii) made available to prospective investors in the issue; ~~or~~

(f) research that is received so that the *firm* may evaluate the research provider's research service, provided that:

(i) it is received during a trial period that lasts no longer than three *months*;

(ii) no monetary or non-monetary consideration is due (whether during the trial period, before or after) to the research provider for providing the research during the trial period;

(iii) the trial period is not commenced with the research provider within 12 *months* from the termination of an arrangement for the provision of research (including any previous trial period) with the research provider; and

(iv) the *firm* makes and retains a record of the dates of any trial period accepted under this *rule*, as well as a record of how the conditions in (i) to (iii) were satisfied for each such trial period;~~.~~

(g) research on listed or unlisted companies with a market capitalisation below £200m, provided it is offered on a rebundled basis or provided for free. The market capitalisation is to be calculated with reference to end-of-year quotes for the preceding 36 calendar *months* preceding the provision of research. For these purposes, *firms* may reasonably rely on the assessment of a third party that the research is on a company with a market capitalisation below £200m;

(h) third party research that is received by a *firm* providing *investment services* or *ancillary services* to *clients* where it is received in connection with an investment strategy primarily relating to fixed income, currency or commodity instruments;

(i) research received from an independent research provider where the independent research provider is not engaged in execution services and is not part of a financial services group that includes an investment firm that offers execution or brokerage services; or

(j) written material that is made openly available from a third party to any *firms* wishing to receive it or to the general public. "Openly available" in this context means that there are no conditions or barriers to accessing it, for example requiring a log-in, sign-up or submission of user information by a *firm* or a member of the public in order to access that material.

[**Note:** articles 24(7)(b) and 24(8) of *MiFID*; article 12(2) and (3) of the *MiFID Delegated Directive* and article 72(3) of the *MiFID Org Regulation*]

…

2.3A.22A G In relation to *COBS* 2.3A.19R(h), since the particular features of the fixed income, currency and commodity markets, whereby portfolio managers and independent investment advisers transact with counterparties based on competitive pricing processes, the pricing of transactions in fixed income, currency and commodity instruments will typically not take into account research services.

…

11 Dealing and managing

…

11.2A Best execution – MiFID provisions

11.2A.1 R (1) Subject to (2) to (4), the following provisions apply to a *firm's* business other than *MiFID business* as if they were *rules*:

(a) provisions within this chapter marked "UK".~~; and~~

(b) ~~*COBS* 11 Annex 1UK (Regulatory Technical Standard (RTS 28)).~~ [deleted]

(2) ~~The following provisions do not apply to *MiFID optional exemption firm's business*:~~

(a) ~~the part of the first sub-paragraph of article 65(6) to the *MiFID Org Regulation* (reproduced at *COBS* 11.2A.34UK) that reads:~~

~~"In particular, when the investment firm select other firms to provide order execution services, it shall summarise and make public, on an annual basis, for each class of financial instruments, the top five investment firms in terms of trading volumes where it transmitted or placed client orders for execution in the preceding year and information on the quality of execution obtained. The information shall be consistent with the information published in accordance with the Commission Delegated Regulation (EU) 2017/576 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the annual publication by investment firms of information on the identity of execution venues and on the quality of execution, or any technical standards made by the Financial Conduct Authority under paragraph 27(b) of Schedule 1 to Regulation (EU) 2014/600."; and~~

(b) ~~*COBS* 11 Annex 1UK (Regulatory Technical Standard (RTS 28).~~ [deleted]

(3) This chapter does not apply (but *COBS* 11.2B applies) to *UCITS management companies* when carrying on *scheme management activity*.

(4) This chapter does not apply (but *COBS* 11.2 applies) to *AIFMs* when carrying on *AIFM investment management functions* and *residual CIS operators*.

…

Execution policies

11.2A.25 UK …

(9) Where an investment firm executes orders for retail clients, it shall provide those clients with a summary of the relevant policy, focused on the total cost they incur. ~~The summary shall also provide a link to the most recent execution quality data published in accordance with [*COBS* 11.2C.1R, *MAR* 5.3.1AR(5), *MAR* 5A.4.2R(3) and *MAR* 6.3A.1R] and paragraph 4C of the Schedule to the Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges, Clearing Houses and Central Securities Depositories) Regulations 2001 for each execution venue listed by the investment firm in its execution policy.~~

…

11.2A.29 G An *investment firm* executing orders should be able to include a single *execution venue* in their policy only where they are able to show that this allows them to obtain best execution for their *clients* on a consistent basis. *Investment firms* should select a single *execution venue* only where they can reasonably expect that the selected *execution venue* will enable them to obtain results for *clients* that are at least as good as the results that they could reasonably expect from using alternative *execution venues*. This reasonable expectation must be supported by relevant data ~~published in accordance with:~~ <u>or by other internal analyses conducted by *investment firms*.</u>

(1) ~~*COBS* 11.2A.38G;~~

(2) ~~*COBS* 11.2A.39R;~~

(3) ~~*COBS* 11.2C; and~~

(4) ~~by other internal analyses conducted by *investment firms*.~~ <u>[deleted]</u>

[**Note:** recital 108 to the *MiFID Org Regulation*]

…

11.2A.31 R (1) A *firm* must monitor the effectiveness of its order execution arrangements and execution policy to identify and, where appropriate, correct any deficiencies. In particular it must assess, on a regular basis, whether the *execution venues* included in the order execution policy provide for the best possible result for the *client* or whether it needs to make changes to its execution arrangements taking into account ~~the~~

~~information published in accordance with:~~ relevant data or by other internal analyses conducted by *investment firms*.

(a) ~~*COBS* 11.2A.38G;~~

(b) ~~*COBS* 11.2A.39R; and~~

(c) ~~*COBS* 11.2C~~. [deleted]

(2) The *firm* must notify *clients* of any material changes to its order execution arrangements or execution policy.

[**Note:** article 27(7) of *MiFID*]

…

11.2A.33 G In order to obtain the best execution for a client, a *firm* should compare and analyse relevant data~~, including that made public in accordance with *COBS* 11.2A.38G, *COBS* 11.2C and article 27(3) of *MiFID* and respective implementing measures~~.

[**Note:** recital 107 to the *MiFID Org Regulation*]

Duty of portfolio managers, receivers and transmitters to act in client's best interest

11.2A.34 UK 65 (1) …

…

(6) Investment firms shall provide information to their clients on the policy established in accordance with paragraph 5 and paragraphs 2 to 9 of Article 66. Investment firms shall provide clients with appropriate information about the firm and its services and the entities chosen for execution. ~~In particular, when the investment firm select other firms to provide order execution services, it shall summarise and make public, on an annual basis, for each class of financial instruments, the top five investment firms in terms of trading volumes where it transmitted or placed client orders for execution in the preceding year and information on the quality of execution obtained. The information shall be consistent with the information published in accordance with the Commission Delegated Regulation (EU) 2017/576 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the annual publication by investment firms of information on the identity of execution venues and on the quality of execution, or any technical standards made by the Financial Conduct Authority under paragraph 20(b) of Schedule 3 to Regulation (EU) 600/2014.~~

Upon reasonable request from a client, investment firms shall provide its clients or potential clients with information about entities where the orders are transmitted or placed for execution.

(7) …

…

(8) This Article shall not apply where the investment firm that provides the service of portfolio management or reception and transmission of orders also executes the orders received or the decisions to deal on behalf of its client's portfolio. In those cases, Articles 64 and 66 of this Regulation, ~~technical standards made under Article 27(10) of Directive 2014/65/EC~~ and rules in [*COBS*] which were relied on immediately before exit to implement Article 27 of Directive 2014/65/EU shall apply.

…

11.2A.36 G A *firm* transmitting or placing orders with other entities for execution may select a single entity for execution only where the *firm* is able to show that this provides the best possible result for their *clients* on a consistent basis and where they can reasonably expect that the selected entity will enable them to obtain results for *clients* that are at least as good as the results that could reasonably be expected from using alternative entities for execution. This reasonable expectation should be supported by relevant data <u>or by other internal analyses conducted by *investment firms*.</u> ~~published in accordance with:~~

(1) ~~*COBS* 11.2A.38G;~~

(2) ~~*COBS* 11.2A.39R;~~

(3) ~~*COBS* 11.2C; and~~

(4) ~~by internal analysis conducted by *investment firms*.~~ <u>[deleted]</u>

[**Note:** recital 100 to the *MiFID Org Regulation*]

…

~~Publishing information on execution quality~~

11.2A.38 G ~~*Execution venues* (other than market makers and other liquidity providers to which *COBS 11.2C* applies) are reminded of the need to comply with the following provisions:~~

(1) ~~*MAR* 5.3.1A R(5);~~

(2) ~~*MAR* 5A.4.2R(3);~~

(3) ~~*MAR* 6.3A.1R; and~~

(4) ~~paragraph 4C of the Schedule to the *Recognition Requirements Regulations*.~~

~~[**Note:** article 27(3) of *MiFID* and *MiFID RTS 27*]~~ [deleted]

11.2A.39 R ~~In accordance with the requirements of *COBS* 11 Annex 1EU, a *firm* which executes *client* orders must summarise and make public on an annual basis, for each class of *financial instruments*, the top five *execution venues* in terms of trading volumes, where they executed *client* orders in the preceding year, together with information on the quality of execution obtained.~~

~~[**Note:** article 27(6) of *MiFID* and *MiFID RTS 28*]~~ [deleted]

…

11.2B Best execution for UCITS management companies

…

Obligation to execute orders on terms most favourable to the scheme

11.2B.22 G (1) A *management company* may specify a single *execution venue*, or a single entity with which it places orders for execution, in its execution policy where it:

(a) is able to show that this allows it to obtain best execution, or, when placing orders for execution, the best possible result, for the *schemes* it manages on a consistent basis; and

(b) can reasonably expect that the selected *execution venue* or entity will enable it to obtain results for each *scheme* that are at least as good as the results that it could reasonably expect from using alternative *execution venues* or entities.

(2) The reasonable expectation in (1)(b) should be supported by~~:~~ relevant data or by other internal analyses conducted by the *management company*.

(a) ~~relevant data published in accordance with *COBS* 11.2A.39R, *COBS* 11.2B.36R, *COBS* 11.2C and the provisions referred to in *COBS* 11.2B.30G; or~~

(b) ~~other internal analyses conducted by the *management company*.~~ [deleted]

…

Monitoring and review of the order execution arrangements including the order execution policy

11.2B.27 R (1) A *management company* must monitor the effectiveness of its order execution arrangements and policy on a regular basis to identify and, where appropriate, correct any deficiencies.

(2) A *management company* that places orders with other entities for execution must in particular monitor the execution quality of those entities on a regular basis to identify and, where appropriate, correct any deficiencies.

(3) A *management company* must assess, on a regular basis:

(a) whether the *execution venues* included in the order execution policy provide for the best possible result for the *schemes* it manages; and

(b) whether it needs to make changes to its execution arrangements taking into account ~~the information published in accordance with *COBS* 11.2A.39R, *COBS* 11.2B.36R, *COBS* 11.2C and the provisions referred to in *COBS* 11.2B.30G~~ relevant data or by other internal analyses conducted by the *management company*.

[**Note:** article 25(4) first sentence, and article 26(3) first paragraph of the *UCITS implementing Directive*]

…

11.2B.30 G A *management company* should compare and analyse relevant data to monitor and to review their order execution arrangements~~, including that made public in accordance with:~~

(1) ~~*MAR 5.3.1AR(5)* (Functioning of an MTF);~~

(2) ~~(Functioning of an OTF);~~

(3) ~~*MAR 6.3A.1R* (Quality of execution); and~~

(4) ~~paragraph 4C of the Schedule to the *Recognition Requirements Regulations*~~. [deleted]

Information requirements

…

11.2B.36 R ~~(1)~~ ~~Where a *management company* executes *scheme* orders or selects other *firms* to provide order execution services, it must summarise and make public, on an annual basis, for each type of *financial instrument*:~~

~~(a)~~ ~~the top five *execution venues* or investment firms where it transmitted or placed orders for execution in terms of trading volumes in the preceding year; and~~

~~(b)~~ ~~information on the quality of execution obtained.~~ [deleted]

~~(2)~~ ~~The information must be consistent with the information published in accordance with *COBS* 11 Annex 1UK (Regulatory technical standard 28) (which applies as *rules* in accordance with *COBS* 18.5B.2R).~~ [deleted]

…

11.2C Quality of execution

11.2C.1 R ~~A *market maker* or other liquidity provider must make available the data detailed in *COBS* 11.2C.2R to the public in the following manner:~~

~~(1)~~ ~~at least on an annual basis; and~~

~~(2)~~ ~~without any charges.~~ [deleted]

11.2C.2 R ~~*COBS* 11.2C.1R applies to data relating to the quality of execution of transactions by that *market maker* or other liquidity provider, including details about price, costs, speed and likelihood of execution for individual *financial instruments*.~~

~~[**Note:** article 27(3) of *MiFID* and *MiFID RTS 27*]~~ [deleted]

…

COBS 11 Annex 1UK Regulatory Technical Standard 28 (RTS 28) is deleted in its entirety. The deleted text is not shown but the annex is marked [deleted] as shown below.

11 Annex 1 UK Regulatory Technical Standard 28 (RTS 28) [deleted]

Annex B

Amendments to the Market Conduct sourcebook (MAR)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

5 Multilateral trading facilities (MTFs)

…

5.3 Trading process requirements

…

Functioning of an MTF

5.3.1A R A *firm* must:

(1) …

…

(5) ~~make available data relating to the quality of execution of transactions on that venue, including details about price, costs, speed and likelihood of execution for individual *financial instruments* to the public in the following manner:~~

~~(a) at least on an annual basis; and~~

~~(b) without any charges; and~~

~~[**Note:** article 27(3) of *MiFID*]~~ [deleted]

…

…

5A Organised trading facilities (OTFs)

…

5A.4 Trading process requirements

…

Functioning of an OTF

5A.4.2 R A *firm* must:

(1) …

…

(3) ~~make available data relating to the quality of execution of transactions on that venue, including details about price, costs, speed and likelihood of execution for individual *financial instruments* to the public in the following manner:~~

(a) ~~at least on an annual basis; and~~

(b) ~~without any charges.~~

~~[**Note:** article 27(3) of *MiFID*]~~ [deleted]

…

6 Systematic internalisers

…

6.3A Quality of execution

6.3A.1 R ~~A *systematic internaliser* must make available the data in *MAR* 6.3A.2R to the public in the following manner:~~

(1) ~~at least on an annual basis; and~~

(2) ~~without any charges.~~ [deleted]

6.3A.2 R ~~*MAR* 6.3A.1R applies to data relating to the quality of execution of transactions on that venue, including details about price, costs, speed and likelihood of execution for individual *financial instruments*.~~

~~[**Note:** article 27(3) of *MiFID*, *MiFID RTS 27* and *MiFID RTS 28*]~~ [deleted]

Annex C

Amendments to the Recognised Investments Exchanges sourcebook (REC)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

2 Recognition requirements

…

2.16A Operation of a multilateral trading facility (MTF) or an organised trading facility (OTF)

2.16A.1 UK Schedule to the Recognition Requirements Regulations, Paragraph 9A-9H

…		
Paragraph 9F – Specific requirements for organised trading facilities: execution of orders		
…		
(4)	The discretion which the [*UK RIE*] must exercise in executing a client order may only be the discretion mentioned in sub-paragraph (5) or in sub-paragraph (6) or both.	
(5)	The first discretion is whether to place or retract an order on the organised trading facility.	
(6)	The second discretion is whether to match a specific client order with other orders available on the organised trading facility at a given time, provided the exercise of such discretion is in compliance with specific instructions received from the client and in accordance with the [*UK RIE's*] obligations under—	
	(a)	section 11.2A of the Conduct of Business sourcebook;
	(b)	Articles 64 to 66 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive;
	(c)	~~Commission Delegated Regulation (EU) 2017/575 of 8 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards~~

		~~concerning the data to be published by execution venues on the quality of execution of transactions; and~~ [deleted]
	(d)	~~Commission Delegated Regulation (EU) 2017/576 of 8 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the annual publication by investment firms of information on the identity of execution venues and on the quality of execution.~~ [deleted]
…		

…

TECHNICAL STANDARDS ((MARKETS IN FINANCIAL INSTRUMENTS REGULATION) (BEST EXECUTION) INSTRUMENT 2021

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the powers and related provisions in or under:

(1) paragraph 20 of Part 2 of Schedule 3 to the Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012; and

(2) the following sections of the Financial Services and Markets Act 2000 ("the Act"):

(a) section 138P (Technical standards);
(b) section 138Q (Standards instruments);
(c) section 138S (Application of Chapters 1 and 2); and
(d) section 137T (General supplementary powers).

B. The rule-making provisions referred to above are specified for the purposes of section 138Q(2) (Standards instruments) of the Act.

Pre-conditions to making

C. The FCA has consulted the Prudential Regulation Authority in accordance with section 138P of the Act.

D. A draft of this instrument has been approved by the Treasury in accordance with section 138R of the Act.

Interpretation

E. In this instrument, any reference to any provision of direct EU legislation is a reference to it as it forms part of retained EU law.

Modifications

F. The FCA revokes the following EU Regulations:

Commission Delegated Regulation (EU) 2017/575 of 8 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards concerning the data to be published by execution venues on the quality of execution of transactions.
Commission Delegated Regulation (EU) 2017/576 of 8 June 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the annual publication by investment firms of information on the identity of execution venues and on the quality of execution.

Commencement

G. This instrument comes into force on [*date*].

Citation

H. This instrument may be cited as the Technical Standards (Markets in Financial Instruments Regulation) (Best Execution) Instrument 2021.

By order of the Board
[*date*]

Pub ref: 007551

FINANCIAL CONDUCT AUTHORITY

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