

Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: Extension of certain MiFID II independence provisions to firms providing personal recommendations to retail clients on non-MiFID business/products so that they are consistent with the provisions applying to MiFID business

Lead regulator: FCA

Date of assessment: 29 March 2018

Commencement date: 3 January 2018

Origin: Domestic extension of EU legislation

Does this include implementation of a Cutting Red Tape review? No

Which areas of the UK will be affected? Whole of the UK

Brief outline of proposed new or amended regulatory activity

The Markets in Financial Instruments Directive (MiFID II) introduced a European-wide standard for 'independent advice' for the first time [Article 24(7) (a)]. However, independent advice has been a feature of the UK advice market for many years.

The Retail Distribution Review (RDR) definition of 'independent advice' was introduced at the end of 2012. Firms needed to consider a broader range of products than before including life policies, units, stakeholder pension schemes, personal pension schemes, investment trusts, packaged products, and structured capital-at-risk products. Firms were expected to inform their clients before they receive advice that they would provide independent advice.

These RDR rules aimed to ensure that independent advice was free from bias towards particular products or any restrictions that would limit the range of solutions that firms could recommend to their clients. Independent advisers were required to objectively consider a range of different types of products from different product providers, so that firms could provide a 'comprehensive and fair analysis' of potential products in a relevant market which could meet the investment needs and objectives of a retail client.

The RDR independence standard applied to all firms making personal recommendations to retail clients in the UK on retail investment products, which include investment products both in scope of MiFID II (structured products and UCITS), and some products outside scope (insurance-based investments and personal pensions).

Similar to the (then) existing RDR domestic rules and guidance, the MiFID II standard seeks to ensure that firms that offer independent advice do not limit the products considered to those of the advisory firm, or to firms with close links to the advisory firm. The MiFID II rules were

also developed to address potential product and provider bias. Investment firms describing their advice as independent must assess a sufficient range of financial instruments. The instruments must be sufficiently diverse in terms of their type and issuers or product providers to ensure they suitably meet the client's objectives, and not be limited to investments issued or provided by closely linked entities.

When considering this aspect for MiFID II implementation, we concluded that the MiFID II and the RDR independence standards are broadly consistent in terms of overall approach, regulatory objective and intended outcome - with no material differences in the levels of consumer protection.

We, therefore, applied the MiFID II standard in place of the RDR standard. And, because under the RDR independent advisers already considered both MiFID and non-MiFID products when making personal recommendations, we proposed taking a similarly cohesive approach when implementing the MiFID II requirements, and applied the MiFID II standard to MiFID financial instruments, structured deposits and other non-MiFID retail investment products for retail clients. This was to ensure consistent regulatory standards for both MiFID and non-MiFID products, a competitive and level playing field, and to prevent potential consumer confusion.

Which type of business will be affected? How many are estimated to be affected?

Firms affected by our discretionary rule changes are those providing financial advice to retail clients on non-MiFID retail investment products.

Using data from the FCA register, we estimate that there are 4,412 such firms. However, the rule changes in question only apply to independent advisers and not to firms offering only restricted advice, which account for 15% of firms providing financial advice.¹ Therefore we estimate the total number of affected firms to be 3,750.

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2016	3 January 2018	10 years	-0.3	0.0	0.2

Please set out the impact to business clearly with a breakdown of costs and benefits

In order to inform our cost-benefit analysis (CBA) for MiFID II implementation consultation purposes, in September 2015 we surveyed approximately 5000 FCA authorised firms, asking for data to support our consultation proposals. We consulted on our proposals in a series of consultations during 2016 and 2017, seeking feedback on the proposals and the accompanying CBA.

Our analysis of costs and benefits for extending the MiFID II independence provisions to firms providing advice to retail clients on non-MiFID business/products is set out on pages 162-164 of Annex 2 (Cost benefit analysis) of CP16/29 (see full reference, and link to CP, below), finalised in PS17/14. Using our baseline for analysis as the (then) existing RDR independence standard (in place since the end of 2012), we considered the costs to firms for the discretionary action described above. In addition, for this impact assessment, we have calculated the familiarisation and gap analysis costs.

¹ FCA, May 2017, Data Bulletin: Issue 9, <https://www.fca.org.uk/publication/data/data-bulletin-issue-9.pdf>

Familiarisation & gap analysis costs

We expect the impacted firms to read the relevant changes in order to familiarise themselves with the detailed requirements of the new rules and guidance. We also expect impacted firms to perform a gap analysis to check their current practices against these expectations.

Based on assumptions on the time required to undertake this analysis, and the cost of this time to firms, we estimate that firms will incur an average cost of £95² each to undertake this work. In aggregate, this indicates an overall cost of £0.4 million.³

In the long run, however, we think firms will face lower costs if they have the same independence standard across their product range, resulting in the reading of, and gap analysis against, regulatory requirements being simpler and quicker.

Remediation costs

The requirements applied to non-MiFID business, in the main, reflect the (then) existing rules and guidance. The differences between the new MiFID II requirement and the (then) existing FCA (RDR) requirement are minimal. As such, we do not expect there to be widespread, significant implications for firms arising from the implementation of MiFID II's independence standard. We believe that the discretionary application of this provision would have a negligible impact on the industry in relation to remediation costs, as we did not alter the effect of the existing rule which applied to these firms.

Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.

We consulted on these requirements in:

- March 2015, FCA Discussion Paper DP15/3: "Developing our approach to implementing MiFID II conduct of business and organisational requirements" - in particular, pages 26-30 (5 pages) of Chapter 6: <https://www.fca.org.uk/publication/discussion/dp15-03.pdf>
- September 2016, FCA Consultation Paper CP16/29: "Markets in Financial Instruments Directive II Implementation – Consultation Paper III" – in particular, pages 55-59 (5 pages) of Chapter 6 (CP proposals); pages 162-163 of the CBA Annex (2 pages); and pages 120-126 of the draft Rules Instrument (7 pages): <https://www.fca.org.uk/publication/consultation/cp16-29.pdf>

Our final feedback on these requirements, and final rules, are set out in FCA Policy Statement PS17/14: "Markets in Financial Instruments Directive II Implementation – Policy Statement II" (July 2017) – in particular, pages 81-82 (2 pages) of Chapter 10 (CP feedback); and pages 117-123 of the final Rules Instrument (7 pages): <https://www.fca.org.uk/publication/policy/ps17-14.pdf>

² The assumptions used to estimate these costs have been derived from a research project on compliance costs that involved consultation with firms and trade bodies, discussions with vendors, a review of previous CBAs, internal FCA consultation, and desk-based research. To put a cost on time, we have sourced salary information for a range of occupations in financial services. Figures for large and medium firms are based on the 2016 Willis Towers Watson UK Financial Services Report. Small firm salaries were sourced from a systematic review of adverts on the website of Reed, cross-referenced with other publicly available sources. We add an allowance for overheads of 30% to all time costs to account for non-wage labour costs, as advocated by the HM Treasury Green Book.

³ This cost estimate has been scaled by 85% in order to account for the impact of the rule changes on the firms affected given the type of financial advice they are likely to provide.