

Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: Extension of MiFID II product governance provisions to non-MiFID firms

Lead regulator: FCA

Date of assessment: 1 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 requires firms to meet certain product governance requirements. These are requirements firms should follow in the design, distribution and ongoing monitoring of products in scope of MiFID, over their full lifespan. As outlined in the FCA's consultation paper CP16/29, we observed that the most frequent reason for past product failures was firms not putting consumers' needs at the centre of their product governance processes.

In the interests of consumer / investor protection, the product governance provisions were designed to ensure that manufacturers and distributors of products act in their clients' best interests during all stages of the life-cycle of products and related services.

Certain activities in relation to MiFID-scope products are carried out by non-MiFID firms. For example, fund managers are not in scope of MiFID but Undertakings for the Collective Investment of Transferable Securities (UCITS) are MiFID products. Therefore, at the time of implementation, the FCA took a discretionary decision to apply these provisions as guidance to firms manufacturing and distributing products in scope of MiFID by way of non-MiFID business, such as Alternative Investment Fund (AIF) managers and (UCITS) managers. This was done to help deliver a consistent approach to the implementation of product governance standards and deliver consumer protection.

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

Firms affected are AIF managers and UCITS managers. We estimate there are 187 firms that will be caught as manufacturers, and 220 firms that will be caught as distributors.

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	-91.2	10.6	53.0

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

The FCA sent out a questionnaire to around 5,000 FCA authorised firms in September 2015, asking for data to support its proposals for consultation in respect of all MiFID II changes. It followed this up with a second round of surveys. It then consulted on its proposals in a series of consultation during 2016 and 2017 on which it sought feedback on the proposals and the accompanying CBA.

In the section below we outline the costs to firms for the discretionary actions described above. The details presented below are drawn from underlying analysis conducted for the CBA in CP16/29 and which was finalised in PS17/14.

One-off costs

Based on responses to the survey, we estimate that 187 firms¹ will incur one-off costs as manufacturers from the FCA's application of the provisions as guidance. We expect the greatest contributor to one-off costs for manufacturer firms will be legal and compliance costs, followed by setting up arrangements to manage relationships with other firms, such as distributors, and training staff about the new procedures. There is significant uncertainty as to the magnitude of these costs, stemming from respondent firms' uncertainty about how the additional guidance would affect them in practice². We therefore estimate a possible one-off market-wide cost of £3.1 million³ for manufacturer firms.

We estimate that 220 firms⁴ will incur one-off costs as distributors from the FCA's application of the provisions as guidance. We expect that, for firms that do not already meet the new provisions, the greatest contributor to one-off costs for distributor firms will be in developing new processes and systems, including IT systems, to comply with the new provisions, followed

¹ Our survey in relation to product governance was addressed to firms undertaking a range of activities in order to receive a broad spread of responses. Our application of the provisions as guidance will affect a more limited range of firms. However, the firms which took part in the survey and would be subject to this application reported estimated costs broadly in line with the costs reported by the wider range of respondents. We estimate that 187 firms will be affected as manufacturers by our application of the provisions as guidance.

² For manufacturers, one-off cost estimates reported in the survey range from £11,000 to £70,000 per firm.

³ This estimate does not include the cost estimates in our survey of one outlier firm. This is because the firm skewed the industry-wide estimates so much we (the FCA) took the approach that we should not include them in the analysis – this is consistent with the approach taken to excluding outliers of this magnitude in other parts of the MiFID II CBA analysis. If we took their figures into account, the one-off estimated cost to the market for manufacturers would increase to £5.9 million. The estimate was also significantly different from that provided by comparable firms.

⁴ Our survey in relation to product governance was addressed to firms undertaking a range of activities in order to receive a broad spread of responses. Our application of the provisions as guidance will affect a more limited range of firms. However, the firms which took part in the survey and would be subject to this application reported estimated costs broadly in line with the costs reported by the wider range of respondents. We estimate that 220 firms will be affected as distributors by our application of the provisions as guidance.

by the costs of training staff about the new procedures⁵. We estimate a one-off market-wide cost of £5.2 million⁶ for distributor firms.

Ongoing costs

Based on responses to the survey, we estimate that 187 firms will incur ongoing costs as manufacturers from the FCA's application of the provisions as guidance. We expect the greatest ongoing costs will be in managing relationships with other firms about the product design and distribution process. Other notable ongoing costs include product testing and compliance monitoring. Ongoing costs are estimated to be larger than one-off costs given the nature of the cost drivers and the need to continue these additional processes throughout the lifetime of new products. Some respondent firms expressed uncertainty in estimating the additional requirements that would result from the extended guidance⁷. We estimate an ongoing market-wide cost of £5.6 million⁸ per year for manufacturer firms.

We estimate that 220 firms will incur ongoing costs as distributors from the FCA's application of the provisions as guidance. We expect ongoing costs⁹ to consist mainly of time spent managing relationships with manufacturer firms and reviewing new products to ensure compliance. Another major contributor is expected to be ongoing staff training in terms of the new product governance provisions. We estimate an ongoing market-wide cost of £4.4 million¹⁰ per year for distributor firms.

The changes proposed to product governance requirements to non-MiFID firms are expected to benefit consumers. For example, consumers should benefit from greater certainty that they are able to buy financial products designed in their interests. These benefits to consumers and society are likely to exceed costs to firms. However, under the Act, benefits to consumers and society are out of scope for impact assessments. These benefits are considered in our cost benefit analysis (CBA) prior to rule changes.

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

The relevant FCA consultation paper for these provisions is: FCA, September 2016, CP16/29: Markets in Financial Instruments Directive II Implementation – Consultation Paper III, <https://www.fca.org.uk/publication/consultation/cp16-29.pdf>

The relevant FCA policy statement for these provisions is: FCA, July 2017, PS17/14: Markets in Financial Instruments Directive II Implementation – Policy Statement II, <https://www.fca.org.uk/publication/policy/ps17-14.pdf>

⁵ For distributors, one-off cost estimates reported in the survey range from £13,000 to £52,000 per firm.

⁶ This estimate does not include the cost estimates in our survey of one outlier firm. If we took their figures into account, the one-off estimated cost to the market for distributors would increase to £6.9 million.

⁷ For manufacturers, ongoing cost estimates reported in the survey range from £25,000 to £31,000 per firm.

⁸ This estimate does not include the cost estimates in our survey of one outlier firm. If we took their figures into account, the ongoing estimated cost to the market for manufacturers would increase to £22.6 million.

⁹ For distributors, ongoing cost estimates reported in the survey range from £11,000 to £44,000 per firm.

¹⁰ This estimate does not include the cost estimates in our survey of one outlier firm. If we took their figures into account, the ongoing estimated cost to the market for distributors would increase to £4.9 million.