Opinion: final
Origin: European
RPC reference number: RPC16-3301(3)-HMT
Date of implementation: January 2018

Regulatory Policy Committee

Markets in Financial Instruments Directive II

HM Treasury

RPC rating: fit for purpose

Description of proposal

The proposal implements the Markets in Financial Instruments Directive II (MiFID II) in the UK via an intelligent copy out into domestic regulations. The UK is required to transpose the directive by 3 July 2017, with the provisions coming into effect on 3 January 2018. The Markets in Financial Instruments Directive (MiFID) is the EU legislation that regulates firms who provide services linked to 'financial instruments' (shares, bonds, units in collective investment schemes and derivatives) and the venues where those instruments are traded. MiFID II updates MiFID in a number of areas in the light of the financial crisis and technological change. The main areas covered are:

- increasing the range of firms in scope of the directive, most notably to cover "Organised Trading Facilities (OTFs)[1];
- updating authorisation and operating conditions;
- increasing investor protection obligations;
- introducing new provisions for regulated markets dealing with algorithmic trading;
- revision of the regime covering market transparency and integrity;
- standardising the forms used for passporting[2] applications;
- enhancing the powers of regulators, particularly with respect to commodity derivatives trading; and
- introducing wholly new requirements in a number of areas, most notably introducing position limits and reporting for commodity derivatives contracts.

Impacts of proposal

The IA sets out a large number of individual areas where costs will be incurred by business, and derives estimates of these costs from an impact assessment published by the European Commission at the time of the MiFID II proposal. The

[1] A platform for multilateral trading interests to interact leading to transactions in financial instruments
[2] Authorisation to do business in another member state without additional regulatory requirements

department has estimated the UK's share of these costs based either on the UK share of the different markets affected by MiFID II or on Financial Conduct Authority (FCA) estimates of the number of firms affected. The areas of highest cost are as follows:

- New trading obligations for all UK market participants are estimated to impose one-off costs of €59 million and ongoing costs of €46 million per annum;
- Information and reporting obligations will lead to one-off costs in the UK of €29 million and ongoing costs of €6 million per annum for firms offering complex products;
- Publication of data regarding execution quality imposes total one-off costs in the UK on an estimated 130 trading platforms and exchanges of €20 million and ongoing costs of €6.6 million per annum;
- Enhancement of the telephone and electronic recording regime imposes one-off costs in the UK of £7.2 million and ongoing costs of £6.8 million[3] per annum on firms across the sector. These estimates are based on FCA estimates rather than the European Commission IA;
- The extension of transaction reporting leads to additional one-off costs in the UK of €59 million and ongoing costs of €1.4 million per annum to all market participants;
- 50 OTFs will incur total one-off costs of €20 million and ongoing costs in the UK of €5 million per annum as a result of the authorisation requirement;
- Extending the scope to emissions allowances trading will impose a one-off cost in the UK on an estimated 150 firms of €15 million and ongoing costs of €4.5 million per annum;
- New rules on the provision of investment advice will impose a one-off cost in the UK of €2.2 million and ongoing costs of €31 million per annum on businesses that provide investment advice to retail clients;
- Around 1,500 firms will incur total costs in the UK of €6 million for providing the FCA with required information concerning algorithmic trading; and
- New reporting requirements on data reporting services providers (DRSPs) will impose one-off costs in the UK of €30 million and ongoing costs of €3.75 million per annum.

The department has used an exchange rate of €1=£0.87 across the appraisal period.

[3] Note these figures are in sterling

Regulatory Policy Committee

The IA sets out a number of benefits from the proposal. These include increased competition, enhanced investor protection and increased transparency in financial markets. The proposal also permits the pass-porting of certain investment activities across Europe. The department has been unable to monetise any of these benefits.

The RPC verifies the estimated equivalent annual net direct cost to business (EANDCB) of £148.5 million. This will be a non-qualifying regulatory provision (EU) that will not score under the business impact target.

Quality of submission

As noted above, the figures in the impact assessment are derived from the European Commission IA. At consultation stage, the department based its cost estimates on a single figure for the UK's share of the wholesale financial market. The department has now updated its cost estimates by scaling the EU estimate for each cost by the UK's share of the relevant markets affected by MiFID II. The IA also sets out the department's reasons for believing that the EU IA remains an appropriate source of information in the UK context.

The department has also drawn on both industry responses to the consultation and internal estimates made by the FCA of the costs that it will incur as a result of the directive. This provides a more accurate picture of the potential costs that will be imposed on businesses in the UK. Overall, the cost estimates have been significantly strengthened since consultation, with the EANDCB figure rising considerably.

The department explains that over 30 market participants and trade associations responded to the consultation. The department specifically asked respondents to the consultation to comment on the figures in the IA, and none provided any criticism of the methodology or the cost estimates. It is disappointing that the consultation did not yield more evidence regarding the cost estimates, which could have been used to improve the department's estimates. In addition, where FCA analysis has been used, it would also have been helpful if reference could have been made to published analysis. The IA would also have benefited from including a summary table containing the cost figures.

The department suggests, but does not explicitly state, that it is implementing the minimum requirements of the directive and using flexibilities where possible to minimise the burden on business. The IA would have benefitted from improved clarity on this point.

Departmental assessment

Classification	Non-qualifying regulatory provision (EU)
Equivalent annual net direct cost to business (EANDCB)	£148.5 million
Business net present value	-£1,302 million
Societal net present value	-£1,302 million

RPC assessment

Classification	Non-qualifying regulatory provision (EU)
EANDCB – RPC validated[4]	£148.5 million
Small and micro business assessment	Not required (European origin)

Michael Gibbons CBE, Chairman

[4] For reporting purposes, the RPC validates EANDCB and BIT score figures to the nearest £100,000.