Regulatory Policy Committee

Extension of MiFID II product governance provisions to non-MiFID firms

Financial Conduct Authority (FCA)

RPC rating: validated

Description of the measure

The Markets in Financial Instruments Directive II (MiFID II) imposed a number of product governance rules on firms which distribute and/or manufacture MiFID type financial instruments or who sell or advise on investment products.

In short, the rules require the distributer to:

- Determine the target market for the product.
- Comply with MiFID disclosure, suitability assessment, inducement and conflicts of interest rules.
- Have product governance controls to ensure the products it offers or recommends are compatible with the characteristics, needs and objectives of the identified target market.
- Ensure it can obtain all required information from the product manufacturers.

In short, the rules require manufacturers to:

- Put product approval processes and governance arrangements in place which address market integrity, conflicts of interest, threats to the underlying functioning and stability of financial markets.
- Identify the potential market for the product.
- Make available, to distributors, all appropriate information on the investment product and the product approval process, including the target market.

Currently, there are non-MiFID firms that distribute and/or manufacture MiFID products and these firms are out of scope of the requirements. The proposal plans to extend MiFID II product governance rules to non-MiFID firms that distribute and/or manufacture MiFID products.

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Impacts of the measure

The FCA estimate that Alternative Investment Fund (AIF) managers and Undertakings for the Collective Investment of Transferable Securities (UCITS) managers will be affected by the changes, a total of 407 firms (187 manufacturers and 220 distributors). All impacts outlined were gathered through a series of industry surveys and consultations.

The FCA have excluded responses from one firm in their calculations of the impacts on business; the regulator deemed the responses of the firm to be outliers.

The FCA estimate one-off costs to manufacturers of £3.1 million, consisting of legal and compliance costs, setting up arrangements to manage relationships with distributors and staff training. For the 220 distributors, the FCA estimate one-off costs of £5.2 million, consisting of developing new processes and systems such as IT systems and training staff on the use of the new systems. If the FCA had included the outlier firm the one-off costs to manufacturers would be £5.9 million and the one-off costs to distributors would be £6.9 million.

For manufacturers, the FCA expect the largest ongoing costs incurred by firms to arise from managing relationships with distributors, product testing and compliance monitoring. These are estimated to be £5.6 million per year in total. For distributors, the largest ongoing costs incurred by firms are expected to arise from managing relationships with manufacturers and reviewing new products to ensure compliance. These are estimated to be £4.4 million per year in total. If the FCA had included the outlier firm the ongoing cost to manufacturers would be £22.6 million and the ongoing cost to distributors would be £4.9 million.

Quality of submission

Issues addressed following RPC's initial review

The regulator has adequately addressed the red-rated point that was highlighted by the RPC.

When originally submitted the assessment was not fit for purpose and the FCA was issued an initial review notice. In the regulator's assessment of the impacts to business it noted that one firm's cost estimates were not included. The FCA was asked to explain why it considered the estimates provided by this firm to be true outliers or to include it in the calculations. The FCA has explained that the estimates provided by the outlier firm skewed the industry-wide estimates to such an extent that they were not a true reflection of cost expected by industry. The FCA do provide the estimated costs to business with the outlier firm included for transparency. The regulator also notes that their approach to outliers of this magnitude is consistent with other cost-benefit analysis conducted relating to the Markets in Financial Instruments Directive II (MiFID II). The RPC does not, in general, consider excluding estimates provided by firms as best practice. However, the regulator has provided the RPC with evidence that comparable firms estimated significantly lower costs and, therefore, the RPC is satisfied with the FCA's treatment of the outlier firm in this case.

The regulator states in its IA that firms had expressed uncertainty around what the proposal would require of them in practice, leading to some concerns regarding the accuracy of cost estimates. The FCA was asked to explain clearly the extent of the uncertainty and whether it would have significant implications for cost estimates. The FCA has not provided this explanation. The assessment would therefore have benefited from a discussion of how respondents' uncertainty around the requirements of the proposal could impact the costs estimates.

The regulator was asked to explain the measure in terms understandable to a general reader and not to assume prior knowledge of the industry and existing regulatory environment. The FCA has not reduced the use of technical language used in the assessment. In communications with the RPC, the FCA has stated that it is advised to use the exact legal phrases surrounding the proposal in the IA, so as not to risk providing an interpretation. The RPC believes this approach is reasonable but that the assessment could have been improved had the FCA also provided clearer description of existing MiFID II product governance rules.

Overall, the assessment is extremely concise and proportionately evidenced. The FCA provides a clear breakdown of the impacts of the proposal upon both manufacturers and distributors within the sector. The regulator's assessment of the likely impacts is based largely upon feedback from affected businesses, gathered through its survey and consultation.

Regulator assessment

Classification	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£10.6 million
Business net present value	£-91.2 million

RPC assessment

Classification	Qualifying regulatory provision (IN)
EANDCB – RPC validated[1]	£10.6 million
Business Impact Target (BIT) Score[1]	£53 million

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