

Title: MiFID 2 Consultation IA No: Lead department or agency: HM Treasury Other departments or agencies:	Impact Assessment (IA)		
	Date: 25/03/2015		
	Stage: Consultation		
	Source of intervention: EU		
	Type of measure: Secondary legislation		
	Contact for enquiries: MiFID2Consultation@HMTreasury.gsi.gov.uk		

Summary: Intervention and Options

RPC Opinion: Awaiting Scrutiny

Cost of Preferred (or more likely) Option				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Measure qualifies as One-Out?	
£-1,125.3	£-1,125.3	£-105.2	No	NA

What is the problem under consideration? Why is government intervention necessary?

The UK is required, as a matter of EU law, to transpose the Markets in Financial Instruments Directive 2 by 3 July 2016 (MiFID 2), it will broadly come into effect on the 3 January 2017. The Markets in Financial Instruments Regulation (MIFIR) will automatically be binding on the UK on this date. As with other EU financial services legislation, MiFID 2 will be implemented in the UK through a combination of secondary legislation and FCA rules. The Government will consult on the technical drafting of the secondary legislation, including (separately) secondary legislation that ensures that certain binary options are regulated and supervised by the FCA rather than Gambling Commission and the MiFID 2 third country regime.

What are the policy objectives and the intended effects?

The policy objective is to implement MiFID 2 so as to comply with UK requirements under EU law. The intended effect of the consultation is to enable industry and legal experts to comment on the draft legislation and to give stakeholders an opportunity to provide the Government with further submissions regarding the MiFID 2 third country regime. In relation to the MiFID 2 third country regime, the Government hopes to elicit further feedback on the costs and consequences of its preferred policy option. Separately it is to ensure that binary options are appropriately regulated in accordance with MiFID and UK legislation.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

In relation to the draft secondary legislation three options have been considered: 1) do nothing, 2) intelligent copy out of MiFID 2 within the structure of existing UK regulation and 3) replace existing UK regime with direct MiFID 2 copy out. Option 1 would put the UK in breach of its obligations under EU law and is therefore not considered further. Option 3 would cause significant disruption and uncertainty to industry. The preferred option is option 2, which is justified by providing greater certainty and continuity to UK financial services regulation. In relation to the MiFID 2 third country regime, the Government considered a range of alternatives to the 'do nothing' option that it has chosen to consult on, including 'opting into' the MiFID 2 third country regime. The 'do nothing' option is preferred due the perceived benefits of the current regime.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 01/2019

Does implementation go beyond minimum EU requirements?			No		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	Micro Yes	< 20 Yes	Small Yes	Medium Yes	Large Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded: N/A		Non-traded: N/A

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

W Leadson

Date:

26/3/15

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -1,444.1	High: -806.6	Best Estimate: -1,125.3

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	160.4	2	78.2	806.6
High	229.3		146.8	1,444.1
Best Estimate	194.8		112.5	1,125.3

Description and scale of key monetised costs by 'main affected groups'

The MIFID review is estimated to impose one-off compliance costs of between €512 and €732 million and ongoing costs of between €312 and €586 million on relevant firms, primarily 'investment firms'. The Government estimates that the UK will bear approximately 36% of this cost, equating to €184 and €264 million (approx. £160 and £229 million on an exchange rate of 0.87) for one-off costs in 2015 and 2016 and €112 and €211 million (approx. £98 and £184 million) for ongoing costs from 2017 onwards.

Other key non-monetised costs by 'main affected groups'

Non-monetised costs may include periodic training and increased costs associated with time spent undertaking new and necessary compliance actions. It is not possible to monetise such costs into an realistic aggregate figure.

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0		0	0
High	0		0	0
Best Estimate	0		0	0

Description and scale of key monetised benefits by 'main affected groups'

Monetised benefits are difficult to quantify with any precision. It is expected that firms and investors will benefit from a decrease in transaction and execution costs, as spreads across a range of financial instruments tighten and transparency is increased. Further, increased competition will also provide investors with more widespread and reasonably priced access to trading venues and central counterparty services.

Other key non-monetised benefits by 'main affected groups'

Benefits to the wider economy and society from the introduction of increased competition, enhanced investor protections and strengthened regulatory obligations in relation to investment firms. MiFID also permits the passporting of certain investment activities across Europe.

Key assumptions/sensitivities/risks	Discount rate	3.5
<p>The Government has assumed the UK's share of the costs reflects its approximate share of the European financial services industry. The Government has estimated a figure of 36%, which various studies have highlighted as the UK's contribution to Europe's wholesale market. The Government recognise that this may not fully capture the UK's retail market. Equally it may not take into account economies of scale.</p>		

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 105.2	Benefits: 0	Net: -105.2	No	NA

Evidence Base (for summary sheets)

Introduction

1. The Markets in Financial Instruments Directive (MiFID) (Directive 2004/34/EC) and its implementing measures (Directive 2006/73/EC and Commission Regulation 1287/2006) took effect in November 2007. MiFID regulates the buying selling and organised trading of financial instruments and the cross-border provision of such services in the European Union (EU). It was part of the Financial Services Action Plan programme of financial services regulation which sought to complete the European single market in financial services.
2. In 2010 the European Commission (EC) consulted on revisions to MiFID which became the revised MiFID (Directive 2014/65/EU) and Markets in Financial Instruments Regulation (MiFIR) (Regulation 600/2014) referred to collectively below as 'MiFID 2'. MiFID 2 will take effect (in the main) from January 2017. The implementing measures under MiFID 2 (which will take the form of delegated acts and technical standards) are currently being worked up and are expected to be completed by early 2016.
3. The EC argued that MiFID had been a success in pushing forward the single market, providing greater consistency in investor protection and reducing the costs of trading of financial instruments. However, it thought change was needed to develop the existing framework based on experience and in particular to address weaknesses highlighted by the financial crisis.
4. MiFID has been transposed into UK law. Where MiFID 2 introduces requirements that go beyond those in MiFID or existing domestic law, these changes can be expected to impact upon market participants.
5. We have set out below a description of the regulatory framework of MiFID and the main changes introduced by MiFID 2 covering:
 - scope;
 - authorisation and operating conditions;
 - investor protection;
 - trading venues;
 - market transparency and integrity;
 - passporting;
 - powers of competent authorities; and
 - new areas covered by MiFID 2, not covered by MiFID.

Scope

6. The investment services and activities regulated under MiFID are: the reception and transmission of client orders; execution of client orders; dealing in financial instruments for a firm's own account; investment advice; portfolio management; underwriting and/or placing; and, operation of a Multilateral Trading Facility (MTF).
7. MiFID 2 adds one new investment service and activity: operation of an Organised Trading Facility (OTF). An OTF is platform for multilateral trading interests to interact leading to transactions in financial instruments. However, in contrast to an MTF where the operator of the platform plays a neutral role in bringing about transactions, the operator of an OTF plays an active role in bringing together buying and selling counterparties and helping them to negotiate the terms of a trade. This will often involve voice trading where the operator contacts counterparties by telephone or electronic communications to develop a transaction.
8. MiFID 2 also creates a new set of data service activities: Approved Reporting Mechanisms (APAs – firms who make public the details of transactions in financial instruments), Approved Reporting Mechanisms (ARMs – firms who report details of transactions to regulators for the purposes of market abuse surveillance) and Consolidated Tape Providers (CTPs – firms who publish details of all transactions in certain financial instruments so the market can have an overview of trading). APAs, ARMs and CTPs are being introduced to ensure both the market as a whole has high quality

information on which to make trading decisions and regulators have high quality information to use for market abuse surveillance purposes.

9. The financial instruments covered by MiFID were: transferable securities; money market instruments; units in collective investment undertakings; financial derivatives and commodity derivatives. The addition that MiFID 2 brings to this list of financial instruments is emission allowances. However, whilst they are not being specified as a financial instrument, advising on and selling structured deposits (bank deposits where the return is linked to something like movements in stock market indices rather than an interest rate) will also be regulated under MiFID 2.
10. The exact scope of the coverage of commodity and foreign exchange derivatives under MiFID 2 is to be specified in implementing measures, which have not been finalised. These implementing measures will lead to a wider set of physically-settled (i.e. where the contract leads to delivery of the underlying commodity) commodity derivative contracts and physically-settled (i.e. where the contract leads to the delivery of the underlying currency) foreign exchange derivative contracts being caught under MiFID 2. These changes to the scope of financial instruments could bring some firms into regulation for the first time and cause some firms already regulated under MiFID to have to extend their regulatory permissions.
11. There are various exemptions from the authorisation requirement (see below) under MiFID and some of these are being changed under MiFID 2.
12. *Financial advisers.* MiFID has an exemption which enables Member States to choose whether to exempt firms providing investment advice and/or receiving and transmitting orders. In the UK, firms who fit into this category can either remain outside of MiFID (but regulated by the FCA) or opt into MiFID gaining the right to provide services outside the UK. Under MiFID 2, firms outside of MiFID under this exemption will be required to be subject to analogous requirements to those regulated under MiFID. This will have limited impact in the UK where firms exempt under Article 3 are already subject to very similar regulation to firms regulated under MiFID.
13. *Proprietary trading firms and commodity derivatives firms.* Firms whose sole activity consists of trading against their own capital ('proprietary trading') can in certain circumstances be exempt from MiFID. This exemption is being narrowed under MiFID 2 to try and ensure in particular that firms using computer algorithms to trade very rapidly (often referred to as 'high-frequency trading firms') will be required to be authorised under MiFID 2. MiFID has wider exemptions for firms who specialise in trading commodity derivatives to keep commercial firms using financial markets for purposes of risk management outside its scope. These exemptions are being narrowed under MiFID 2.

Authorisation and operating conditions

14. Authorisation under MiFID is reserved to those performing investment services or activities as a regular occupation or business on a professional basis (entities authorised under other EU legislation dealing with collective investment schemes and banks may also perform MiFID services and activities subject to compliance with certain of the standards in MiFID). Firms authorised under MiFID are known as 'investment firms'. This remains unchanged under MiFID 2.
15. In order to receive authorisation firms are required to have suitable management and controllers (owners and others able to exert control over the management) and for any changes to management and control to be notified to a firm's regulators. The provisions dealing with management and governance in MiFID 2 are a significant development on those in MiFID. They specify in much greater detail the requirements of management boards and the way in which they

will operate. This greater detail is broadly consistent with developments in the UK regulation since the financial crisis to increase accountability in financial services firms.

16. To be authorised under MiFID investment firms have to be members of investor compensation schemes and have sufficient regulatory capital as set out in separate EU legislation dealing with capital requirements. This is unchanged under MiFID 2.
17. Investment firms under MiFID are required to have adequate organisational structures and arrangements in the following areas:
 - compliance;
 - management of conflicts of interest;
 - systems and controls, including risk management, outsourcing critical functions and business continuity;
 - record keeping; and
 - safeguarding of clients' assets and funds.
18. These provisions have been updated in MiFID 2. For example, requirements on record keeping and client assets have been updated (along the lines of similar developments in the FCA's rules since MiFID came into effect) and new provisions have been added on product governance. The latter are requirements designed to ensure that when manufacturing or distributing financial instruments firms have arrangements in place to understand the products and ensure they are sold to people for whom they are likely to be suitable. Again the FCA already has requirements in this area.
19. MiFID 2 is introducing additional organisational requirements for algorithmic trading (i.e. trading where computers determine some aspect of the parameter of an order). This builds on, but goes beyond, guidelines on automated trading adopted under the existing directive by the European Securities and Markets Authority ('ESMA'). The requirements seek to ensure that firms have proper governance, testing and continuity arrangements around their algorithmic trading to minimise disruption to trading on financial markets. They also seek to ensure that firms undertaking market making type activities are subjected to market making obligations under the rules of trading venues.
20. There are separate but similar authorisation and organisational requirements for providers of data services (ARMs, APAs and CTPs). In particular, these focus on ensuring the integrity and security of the data that these entities will handle. It is not currently possible to make a precise estimate of the number of data service providers who will seek authorisation in the UK. But based on the regimes similar to those of APAs and ARMs that the FCA already has in place it is possible that there will be under 15 data service providers in the UK under MiFID 2.

Investor protection

21. MiFID introduced a harmonised framework for investor protection – that is a set of rules designed to ensure that, in their interactions with clients, investment firms act in the best interests of their client.
22. Key aspects of the investor protection measures in MiFID include:
 - general obligations;
 - suitability and appropriateness;
 - best execution; and
 - client categorisation.
23. *General obligations.* Under MiFID, investment firms are required to act honestly, fairly and professionally and in accordance with the best interests of their clients, communicate in a way that is fair, clear and not misleading, and provide clients with appropriate information on the firm, the services it offers and the associated costs and only make or receive payments linked to services provided to clients in limited circumstances.
24. MiFID 2 makes significant revisions to these obligations. Three of the key changes are as follows. First, firms will be required to inform clients whether the investment advice service they provide is independent. Second, those providing independent investment advice and portfolio management will only be able to receive minor non-monetary benefits from third parties in relation to services

they provide to clients. Third, investment firms will need to make much more detailed disclosures of costs and charges.

25. The detail of these changes are being included in delegated acts. The EC will publish a cost-benefit analysis of the delegated acts when it adopts them in mid-2015.
26. *Suitability and appropriateness.* Under MiFID, when providing services to a client, firms are required to obtain information from the client to help them determine either the suitability (in the case of investment advice and portfolio management) or appropriateness (in the case of other services) of the services and products for the client. This information can include the client's knowledge and experience in the investment field. The information collected should take into account the nature of the service or product, and the client's retail or professional status. Firms can provide execution services to clients without collecting such information where the client asks for such a service and the instruments involved are 'non-complex'.
27. MiFID 2 is making revisions to the suitability and appropriateness obligations but not fundamentally remaking the way they operate.
28. *Best Execution.* Best execution in MiFID is the obligation on firms to obtain the 'best possible result for their clients' when executing orders for financial instruments in the absence of specific instructions from the client. In seeking to deliver 'best execution' a firm should take a wide-range of factors into account, such as, price, costs, speed, likelihood of execution and settlement, size, and the nature of the order and other relevant considerations. The obligation on firms requires them to establish a policy to achieve 'best execution'.
29. MiFID 2 does not change the main aspect of the best execution obligation. However, it seeks to ensure that firms take a more rigorous approach to meeting their obligations including their disclosures to clients. Execution venues will be required to publish standardised information on the quality of order execution and investment firms handling client orders will need to provide information on the execution venues they use and the quality of execution quality they obtain.
30. The detail of the new disclosures under the best execution rule will be included in technical standards.
31. *Client categorisation.* MiFID graduated its protections for clients depending on whether they were retail, professional or eligible counterparties. Investment firms are able to conduct transactions with entities, such as other financial institutions authorised under domestic or Community law, classified

as 'eligible counterparties' without the conduct of business, best execution and part of the client order handling rules applying.

32. MiFID 2 extends some conduct protections to investment firms' dealings with eligible counterparties, particularly in regard to the provision of information. It also strengthens the protections afforded to professionals.

Trading venues

33. MiFID built on the already established concept in EU legislation of a "regulated market" ("RM") (entities normally referred to as exchanges). An RM is a venue for the multilateral trading of financial instruments under a set of non-discretionary rules set by a market operator.
34. The framework MiFID established for the regulation of RMs has echoes of the regulation of investment firms in respect of the conditions for authorisation and the general operating conditions. There are requirements governing:
- authorisation;
 - the suitability of the management;
 - the suitability of those who control the management; and
 - organisation.
35. The main change MiFID 2 makes here is to update the provisions dealing with the suitability of the management in the same way as the similar provisions for investment firms.
36. MiFID also has provisions which deal with the specifics of regulated markets. These relate to:
- admission to trading of financial instruments;
 - suspension and removal of instruments from trading;
 - access to regulated markets;
 - compliance with the rules of the market;
 - clearing and settlement.
37. These provisions are aimed at investor protection and ensuring that a regulated market is properly run, having clear, transparent and non-discriminatory rules which are properly monitored and enforced. Aside from in relation to the suspension and removal of instruments from trading, MiFID 2 leaves these provisions largely unchanged.
38. As with investment firms, MiFID 2 introduces new provisions for regulated markets dealing with algorithmic trading which build on and go beyond those in the ESMA automated trading guidelines. The requirements seek to ensure that regulated markets have proper governance, testing and continuity arrangements around algorithmic trading to minimise disruption to trading on their markets. They also seek to ensure that trading venues encourage market making particularly in stressed market conditions.
39. MiFID also established a second category of trading venues, MTFs. These are defined in the same way as regulated markets but have slightly different obligations to RMs. For those operating MTFs, whether they are investment firms, credit institutions or operators of regulated markets, MiFID sets out provisions governing how MTFs should operate. These draw on aspects of the regime covering regulated markets. They require that MTFs have:
- transparent criteria for determining the financial instruments that can be traded under their systems;
 - non-discriminatory rules for determining access to their systems;
 - rules to ensure fair and orderly trading on their systems;
 - rules to facilitate efficient settlement of transactions concluded through their systems.
40. MiFID 2, as discussed above, creates a new category of trading venue: OTFs. OTFs follow similar organisational requirements to MTFs. However, they are distinct from RMs and MTFs in three key ways. First, again as noted above, the operator of an OTF must play an active role in bringing about transactions on its platform by exercising discretion. Second, following on from the first point, an operator of an OTF is subject to conduct rules such as best execution because of the active role

they play in bringing about transactions. Third, OTFs are only allowed to trade bonds and derivatives and not shares and Exchange Traded Funds.

Market transparency and integrity

41. *Trading transparency.* MiFID introduced an extensive framework for market transparency and integrity. These provisions were designed to ensure that the price formation process is as efficient as possible with investors having access to a wide range of pre and post-trade information.
42. The transparency provisions in MiFID relate only to shares. When RMs and MTFs trade shares admitted to trading on RMs they have to make public information about the price and volume at which their members wish to trade ('pre-trade transparency') and the price and volume of transactions ('post-trade transparency'). The provisions in MiFID codified and harmonised what RMs and MTFs were already doing.
43. The regime included waivers from pre-trade transparency. In specified circumstances, trading could occur without trading interest having previously been made public to the market as a whole (sometimes referred to as 'dark trading'). The implementing measures also specified when, and for how long, delays could be granted from the obligation for post-trade transparency to occur within three minutes. These exceptions and delays were intended in particular to assist those providing liquidity to the market by trading against their own capital to be able to manage their risk effectively.
44. MiFID 2 revises the transparency regime on trading venues for shares and introduces a new regime for instruments like shares (such as exchange traded funds) and bonds and derivatives. As with the existing regime there are pre-trade transparency waivers and delays from post trade transparency. For shares the existing waivers have been narrowed to provide for greater transparency and it is likely that post-trade delays will be reduced. In addition to the narrowing of pre-trade transparency waivers for shares, there will be caps on certain forms of dark trading which if exceeded in a particular instrument will lead to the suspension of certain dark trading waivers for a period of six months.
45. MiFID also introduced transparency provisions for investment firms trading the most liquid shares when acting as market makers outside an RM or MTF. Investment firms acting in this capacity on a frequent, systematic and organised basis (something to be assessed on a qualitative basis) had to inform their national regulator that they were 'systematic internalisers' (SIs). In respect of dealings in shares deemed to have a 'liquid market' in sizes up to 'standard market size', SIs have to publish quotes which are visible to the market as a whole. Business can only be done at prices away from these quotes where the transaction being conducted is larger than that customarily undertaken by a retail investor, and where the client they are dealing with is a professional client.
46. MiFID 2 significantly revises this regime. For trading in shares, the determination of whether an investment firm is an SI will be based on whether a firms trading crosses certain quantitative thresholds. This will increase the number of SIs (there are currently 9 in the UK). Price improvement will also be allowed for dealings with retail clients in justified circumstances. The regime is also being extended to exchange traded funds and other instruments that resemble shares, and bonds and derivatives. In respect of the latter the transparency requirement will apply to dealings in liquid instruments below a Size Specific to the Instrument (SSTI), which will be set in a technical standard, and the obligation will be to quote in response to a request to a client, with the posted quote being available to other clients of the firm to the extent possible with good risk management when trading on risk in this manner. For bonds and derivatives there will also be quantitative criteria to identify SIs. It is not possible at this stage (the quantitative thresholds have yet to be set) to estimate the number of SIs in the UK who will trade shares and derivatives.
47. MiFID requires that where firms execute transactions away from RMs and MTFs in shares admitted to trading on RMs that they make public the details of the transactions (but can benefit from the same regime for delayed post-trade transparency as applies to transactions carried out on RMs and MTFs). Under MiFID 2 this is being extended to instruments like shares and bonds and derivatives.
48. *Market integrity.* Investment firms are required under MiFID to keep records of the transactions they carry out for at least five years, so that regulators can have access to them if required to ensure the directive and wider obligations, such as those relating to money laundering and market abuse, are adhered to. They also have to report to regulators the transactions they conduct in instruments

which are admitted to trading on regulated markets before the close of the following working day. The FCA receives about 12 million such transaction reports a day.

49. MiFID 2 expands the transaction reporting requirement to a wider range of financial instruments including those admitted to trading on MTFs and OTFs. Provisional estimates suggest this might increase the number of transaction reports sent to the FCA each day to 20 million. It will also increase the number of fields a firm might have to complete for each report in the region of threefold (this will be set in the technical standards).
50. MiFID 2 also requires trading venues to keep details of orders sent to their trading systems and harmonises the form in which this information will be held. These records will be made available to regulators upon request.

Passporting

51. A key purpose of MiFID was to facilitate cross-border activity. It provides that firms to have rights to do business outside of the member state in which they are authorised without being subject to additional regulatory requirements ('passporting').
52. *Cross-border right to do business.* MiFID provides investment firms with the right to provide services on a cross-border basis (such as by telephone or by the internet) without having additional regulatory requirements relating to matters covered by the directive imposed upon them by the host member state: that is for business with clients in other Member States their home regulator's requirements apply. They do, however, have to go through a procedure of notifying their home regulator which then passes the information on to the regulator in the Member State in which the investment firm is seeking to do business. Regulated markets and MTFs are also given the right to place trading screens in countries outside that in which they are authorised without the pre-approval of domestic regulatory authorities.
53. The rights and regime described above are unchanged under MiFID 2. The only real changes are to standardise the forms used for passporting applications and to provide for additional information to be provided to host regulators in certain circumstances when banks are providing investment services and activities.
54. *Right to establish branches.* Investment firms are also given the right in MiFID to establish branches in other Member States without going through a separate authorisation process. As with cross-border business, however, they do have to provide details about their branch to their home regulator for onward transmission to the regulator in the Member State in which they wish to establish a branch. Branches, however, come under the responsibility of the regulators of the Member State in which they are established in respect of their obligations under the Directive concerning conduct of business, best execution, client order handling, transactions reporting and pre- and post-trade transparency.
55. As with doing business cross-border, the rights and regime described above are unchanged under MiFID 2. The only real changes are to provide for standardised forms for passporting applications and additional information to be provided to host regulators in certain circumstances when banks are providing investment services and activities.
56. The new passporting forms were discussed in ESMA's high level cost-benefit analysis of technical standards. This concluded that there would be some minor costs for regulators and firms but there would be benefits to end consumers from regulators having access to better information about passporting firms and therefore being better placed to supervise them.

Powers of Competent Authorities

57. MiFID has provisions dealing with the designation of (and co-operation between) 'competent authorities' (the Directive's terminology for regulators) within Member States, the powers of regulators and co-operation between regulators in different Member States.
58. MiFID requires member states to designate competent authorities to carry out each of the duties that fall to competent authorities under the Directive. Where there is more than one competent authority under the Directive in a Member State, they are required to have clearly defined roles and to co-operate closely. This is unchanged under MiFID 2.
59. Under MiFID, competent authorities wide-ranging powers to enforce the Directive. These include rights to gain access to documents, to gain access to telephone records, to require trading in financial instruments to be suspended, and to adopt measures to ensure firms comply with their obligations. These powers are expected to be backed up by appropriate sanctions. Such

sanctioning powers are, however, balanced by a right of appeal to the courts against regulatory decisions. The rights of individuals are also catered for by a requirements that encourage Member States to establish complaints handling tribunals for the speedy resolution of investor grievances and to safeguard professional secrecy.

60. Under MiFID 2 the powers of competent authorities are being enhanced. For example, they are being given powers to intervene in positions in commodity derivatives contracts and the selling of certain financial instruments and to remove individual directors from a board. Member States are also required to ensure that the pecuniary sanctions that can be imposed for infringement of MiFID 2 must at least meet certain thresholds.
61. MiFID 2 also enhances the role of ESMA. In some areas (like transparency waivers and position limits) it issues an opinion on decisions taken by national regulators. These opinions are not binding but obviously national regulators will take a dissenting opinion from ESMA very seriously. ESMA is also given, in very limited circumstances, the power to reduce individual positions of position holders in commodity derivatives.
62. Regulation cannot operate effectively simply on a Member State by Member State basis. The Directive's key purpose is to foster cross-border activity. Cross-border activity inevitably requires competent authorities in different Member States to co-operate, both to facilitate the operation of the single market and to protect its integrity. MiFID set out a framework to ensure that regulators in different Member States are obliged to co-operate and have the ability to do so by passing on information. This framework remains in MiFID 2.
63. There may, however, be circumstances in which co-operation does not work. MiFID, in common with other financial services directives, provides, in these circumstances, precautionary powers for host-state regulators to take action against firms who are subject to the supervision of other regulatory authorities. These powers, are expected only to be used in extreme circumstances. MiFID 2 retains these provisions.
64. *UK competent authorities.* The FCA, PRA and Bank of England will all be competent authorities for MiFID 2 but the main burden of work will fall to the FCA. Implementation will involve significant one-off costs for the authorities.

New aspects of MiFID 2

65. There are several key areas where MiFID 2 does not build on MiFID as such but introduces wholly new requirements. These include:
 - position limits and position reporting for commodity derivatives;
 - trading obligations for shares and derivatives;
 - access to market infrastructure and benchmarks; and
 - access of firms from outside the EU providing investment services and activities to clients in the EU.
66. *Position limits and position reporting.* As a result of concerns about possible instances of market abuse and disorderly trading and settlement related to commodity derivatives contracts, there is a new regulatory regime in MiFID 2. This requires limits to be set (by national regulators following a methodology to be set in technical standards) on the size of a position someone can hold in each commodity derivatives contract traded on a trading venue and economically equivalent contracts traded away from a venue (there will be different limits for the month before a contract expires and other maturities).
67. Details of positions will need to be reported to national regulators on a daily basis to support this regime. Information will also need to be sent to ESMA on a weekly basis to enable aggregated weekly reports to be published showing the positions of certain categories of traders in each contract.
68. The EU's two biggest commodity derivative RMs are based in the UK and there are in the region of 1,800 commodity derivative contracts trading on trading venues in the UK.
69. *Trading obligations for shares and derivatives.* To try and protect the price formation process in shares, MiFID 2 requires investment firms executing transactions in shares trading on RMs and MTFs (and equivalent venues outside the EU) to do so on a trading venue or an SI (subject to

certain limited exceptions). The intention is to maximise the amount of trading that takes place inside the framework of MiFID 2's pre-trade transparency regime.

70. There is also a trading obligation for derivatives resulting from the 2009 G20 conclusions. G20 members committed themselves to reforms of financial markets including requiring derivatives subject to an obligation to be cleared through a Central Counterparty Clearing House (CCP) to be in most circumstances traded on trading venues within a transparency regime. The trading venues permitted are RMs, MTFs, OTFs and equivalent venues outside the EU. Once a financial instrument is subject to a clearing obligation under EMIR, ESMA will assess its liquidity and, if appropriate, bring forward a technical standard imposing a trading obligation. The purpose of the obligation is to help strengthen the resilience of financial markets by having more trading taking place in a transparent environment on properly regulated trading venues.
71. *Access to market infrastructure and benchmarks.* MiFID helped to stimulate competition between trading venues. MiFID 2 seeks to push this process further by facilitating access of CCPs to trading venues, trading venues to CCPs and access of CCPs and trading venues to benchmarks.
72. The provisions dealing with access to CCPs require CCPs to clear contracts from trading venues requesting access on a non-discriminatory basis in terms of collateral requirements and cross-margining. Requests for access can only be turned down by CCPs where they would involve significant undue risk (regulators can also prevent them where they would threaten the smooth and orderly functioning of markets).
73. The provisions dealing with access to trading venues require trading venues to provide trade feeds on a non-discriminatory basis to CCPs that wish to clear transactions in financial instruments on that trading venue. Again there are limited grounds on which a trading venue can reject a request for access or a regulator can block a request.
74. The provisions dealing with access to benchmarks are about a rate, index or figure made available to the public and by which reference to the amount payable under a financial instrument or the value of a financial instrument is determined. Much trading is based on benchmarks and without access to benchmarks the rights of access to market infrastructure discussed in the two previous paragraphs would be ineffective. Access to benchmarks has to be provided on a fair, reasonable and non-discriminatory basis and at a reasonable commercial price. New benchmarks do not have to be licensed until they have been in existence for 30 months.
75. There are various transitional arrangements relating to the application of the access provisions in MiFID 2 and therefore their full effect will not be felt from January 2017.
76. *Access of non-EU firms to EU markets.* MiFID effectively leaves it up to individual Member States as to how to regulate access of non-EU firms to clients based in a Member State. MiFID 2 seeks to introduce a more harmonised regime. Where the EC determines that a country outside the EU has a regulatory regime that is equivalent to that provided for under MiFID, firms regulated in such a country will be able to provide from their home country investment services and activities to professional clients (other than those who have opted up from retail client status) and eligible counterparties based in the EU. In certain circumstances, they might also be permitted to have a branch in an EU country and provide services across the EU from that branch to the same sort of clients as with the arrangements for the cross-border provision of investment services and activities. Member States are given the discretion to determine whether to require non-EU firms to establish a branch in their jurisdiction when dealing with retail clients (and professional clients who have opted up from retail client status). If MSs exercise this option there are harmonised conditions for the operation of branches.

Rationale for intervention

77. As noted above, MiFID 2 determines the rules of operation for EU financial markets across a range of asset classes (including shares, bonds, derivatives, and structured products). It covers firms that as a regular occupation or business provide investment services and/or perform investment activities on a professional basis.
78. In recent years more investors have become active in the financial markets and are offered an even more complex wide-ranging set of services and instruments. In this respect, MiFID was considered necessary to provide for the degree of harmonisation needed to offer investors a high level of

protection and to allow investment firms to provide services throughout the Union. It has brought cost efficiencies to investors (through, for example, reduction in execution costs), as well as strengthening investor protection.

79. The further evolution of financial markets since MiFID has exposed the need to strengthen the framework for the regulation of markets in financial instruments, including where trading in such markets takes place over-the-counter, in order to increase transparency, better protect investors, reinforce confidence, address unregulated areas, and ensure that supervisors are granted adequate powers to fulfil their tasks. These objectives underpin the now finalised MiFID 2.
80. These new provisions contribute towards achieving the general objectives of MiFID 2, which are to:
- strengthen investor confidence,
 - reduce the risks of market disorder;
 - reduce systemic risks; and
 - increase efficiency of financial markets and reduce unnecessary costs for participants.
81. The final Markets in Financial Instruments Directive and Regulation texts were published in the Official Journal of the EU on 12 July 2014. Member States have until 3 July 2016 to transpose the directive and it will enter into application on 3 January 2017. The Regulation will automatically, as a matter of EU law, have effect at the specified date for domestic law purposes. However, the Directive requires Member States to transpose its provisions into national law.

Consultation

82. As with other EU financial services legislation, MiFID 2 will be implemented in the UK through a combination of secondary legislation and FCA rules. Although the UK is required to implement the Directive and therefore has little discretion in this respect, it is important to consult early and as fully as possible in relation to the technical drafting of the secondary legislation required to achieve this. This is intended to ensure that the final regulations transpose the MiFID 2 requirements in the best way possible. It will also enable market participants affected by MiFID 2 requirements to understand how these obligations under the Directive will apply to them through domestic legislation, allowing them to plan for these impacts. As to how the UK implements the MiFID 2 third country regime (explained further below) there is a degree of policy discretion.
83. Draft secondary legislation will also be provided in relation to transferring the supervision of binary options from the Gambling Commission to the Financial Conduct Authority. Binary options are a form of financial contract which pay a fixed sum if it expires in the money, or nothing at all if it expires out of the money. At present, the way binary options are addressed in UK legislation means they are classified as bets and are supervised by the Gambling Commission, rather than the FCA. The Government will be providing draft legislation to ensure that these instruments are regulated appropriately in accordance with MiFID.
84. In this impact assessment, the assumptions for the monetised costs and benefits to firms that provide services regulated by MiFID 2 draw on the European Commission's MiFID 2 Impact Assessment carried out by European Economics and more discrete qualitative assessments carried out by the UK Parliament and other government bodies. The consultation will ask respondents their assessment of and further information on the costs and benefits for MiFID 2 set out in this impact assessment, which is a consultation stage impact assessment.

Draft Secondary Legislation

85. Member States must complete the transposition of the Directive by 3 July 2016. In order to do this the UK must introduce secondary legislation to domestically implement MiFID 2. There is little discretion in relation to this aspect of the intervention. However, the Government considers that stakeholders will appreciate being able to review and provide technical drafting comments in relation

to the draft secondary legislation as early as possible. The intention therefore is to be able to receive this feedback and where appropriate incorporate comments into secondary legislation.

Third Country Regime

86. As set out above, MiFID 2 provides for a specific third country regime. In more detail, the primary features of this regime are the following:
- where a non-EEA firm seeks to provide investment services in the UK to a retail or an elective professional client (i.e. a client that has elected to be treated as a professional rather than a retail client) that EEA firm must establish a branch in that Member State before doing so;
 - in order to be authorised that branch has to comply with a series of harmonised criteria, such as having sufficient initial capital, the third country where the non EEA firm is based pays due regard to relevant anti-money laundering regulations and there are cooperation arrangements in place between the third country and the Member State; and
 - where a non-EEA firm establishes a branch in a Member State, there is the possibility that it will have the ability to passport across the EU in relation to its wholesale business (where, amongst other things, the EU adopts an equivalence decision in relation to the third country i.e. deeming this country to have a broadly equivalent regulatory architecture).
87. Under the UK's current regime third country firms can conduct certain investment activity without the need for authorisation, if they can rely on a specific exclusion. The Government considers that this regime currently works reasonably well both in terms of providing a competitive market place while balancing investor protection. Implementing the MiFID 2 third country regime may act to increase the regulatory burden on firms and narrow existing exclusions that permit economic activity to take place in the UK. For this reason it is proposed that the UK will consult on the consequences of not implementing the MiFID 2 third country regime and continuing with its current system. Any evidence or view provided in response to the consultation will be critically assessed to determine whether the UK's policy preference should be reassessed.

Binary Options

88. Binary options which reference financial instruments are not currently considered to be financial instruments themselves under FSMA and are supervised as bets by the Gambling Commission. On reflection the Government considers that the more accurate approach is that they should be classified as financial instruments under MiFID and therefore should fall within the FCA's regulatory remit.
89. The Government will provide draft secondary legislation in relation to this, so that industry can provide comment and feedback in relation to the proposed drafting and the consequences of it.

Policy objective

90. To ensure that the UK meets its legal requirements under European law and to inform policy making, by eliciting views and data from stakeholders.

Description of options considered (including do nothing)

Options for Draft Secondary Legislation

91. The UK is required, as a matter of European Law, to transpose the Directive into UK law by the 3 July 2016. The UK has little discretion in relation to this. The purpose of providing draft secondary legislation is to provide stakeholders with the chance to comment on the drafting and raise any technical concerns they may have.
92. The alternative option is to directly copy out the Directive. Although the Government has considered this, it would require substantial changes to the existing UK regime that would be disruptive both to industry and regulatory authorities. The UK, for instance, could remove much of the existing legislation set out in the Regulated Activities Order 2001 and Financial Services Markets Act 2000 and replace it with a direct MiFID 2 copy out. However, the Government does not consider this an appropriate option given that the current arrangements and legislation are well known by UK market

participants. It is considered that such a wholesale change to the way the UK sets out its financial markets legislation might involve greater complexity and confusion than embedding the necessary MiFID 2 provisions within the existing legislative architecture.

93. It is not possible to consider a true 'do nothing' option as this would place the UK in breach of its obligations under EU law.

Options for Third country Regime

94. As noted above MiFID 2 provides Member States with discretion to require a third country firm providing investment services to retail and elective professional clients to establish a branch in that Member State. It also sets out certain harmonised criteria for authorisations of branches for third country firms. The option of adopting the MiFID 2 third country regime has been considered. In particular, adopting the MiFID 2 branch requirements on investor protection grounds. On balance, however, it is considered that the UK's current regime is both appropriate in terms of striking the right balance between competitiveness and investor protection. However, the Government will use the consultation to solicit views from industry stakeholders on the economic and investor protection consequences of remaining outside of the MiFID 2 third country regime.

Options for Binary Options

95. As above in relation to the draft secondary legislation, if the UK acted to remove its current regime it would be possible simply to rely on MiFID copy out in relation to ensuring certain binary options are regulated instruments. However, for the reasons given above, the Government does not favour this approach. It is not possible to consider the option of doing nothing, as this may place the UK in breach of its obligations under EU law.

Monetised and non-monetised costs and benefits of each option (including administrative burden)

Monetised and non-monetised costs of draft secondary legislation

96. There have been a number of impact assessments carried out in relation to MiFID 2 in its entirety and also on discrete aspects. A number of these assessments are drawn on below.
97. When adopting its proposal for MiFID 2 the European Commission published an impact assessment. The impact assessment was in effect composed of three main elements. First, an extensive qualitative assessment of the policy options the Commission had chosen against a baseline of no revision to MiFID and looking at some other policy options. This assessment drew on academic literature and a large variety of other sources of information about the EU's financial markets. Second, an attempt to estimate the compliance costs of the Commission's proposals.

Third, a discussion of the possible indirect economic effects, in particular considering the potential impacts on liquidity of the transparency proposals.

98. The methodology used for the estimate of the compliance costs was the EU Standard Cost Model. The model is based around identifying the average cost of activities and multiplying that by how many times a year they are performed. The key elements of the approach were as follows:

- identify the main obligations and classify them according to a typology;
- for each type of obligation identify the type of activity performed;
- obtain a picture of the target groups looking at size, type and location;
- identify the frequency of the required actions in the course of a year;
- look at costs based on time spent performing an action, the hourly pay of those performing the action, acquisition costs of equipment and supplies and depreciation period;
- estimate the number of entities in each target group; and
- extrapolate data to EU level.

99. To assist in this approach survey work was done with market participants to understand their current practices and the challenges that implementation would pose. This was supplemented by use of literature, including cost-benefit studies, which could help to provide insight.

100. In our assessment, such an approach provides a good framework for ensuring consistency of approach to making a high-level estimate of the compliance costs of regulations. Of necessity it has certain limitations. These include:

- regulatory change will cause behavioural changes on the part of investors and intermediaries and this is unlikely to be properly captured in point estimates of compliance costs;
- the estimates were made in 2011 and MiFID 2 will not take effect until 2017 and therefore the gap between assessment and impact is sizeable;
- extrapolations to the EU level provide a rough and ready way of developing estimates that may not take adequate account of national specificities and the diversity of business models; and
- the proposals on which the assessment is based are different from those in the final legislation, although there is substantial overlap between the two, and at the time there was no knowledge of the specifics of the implementing measures which provide a lot of the detail about how obligations will work.

101. As this impact assessment was undertaken in 2011, prior to the negotiation of MiFID 2, these impacts will not be fully aligned with the finalised text of MiFID 2. We have therefore noted below where the major changes between the Commission's proposal and the finalised legislation are:

- enhanced requirements on the disclosure of costs and charges;
- a double-volume cap on dark trading in equity and equity-like financial instruments;
- a trading obligation for shares which requires to be completed on a trading venue or an SI;
- a requirement to impose position limits on each and every commodity derivatives contract traded in the EU.

102. The overall effect of these changes since the proposal will be to increase compliance costs. The most significant of these changes could be considered the costs and charges changes. Investment firms are already required to make disclosures of costs and charges but not to the specified format under MiFID 2. There is a related piece of European legislation on the disclosure of product charges that is related to the obligation in MiFID 2 and which makes it difficult to separate out the costs of the two initiatives. However, MiFID 2 will undoubtedly require investment firms to make significant systems investment in order to produce the required data.

103. Overall the Commission impact assessment estimated that the one off costs of implementation of MiFID 2 were in the range of €512 to €732 millions and the ongoing costs €312 to €586 millions.

104. The Commission did not provide an estimate for how this cost would break down for individual Member States. The Government's best estimate at this time is that the UK will bear approximately 36% of this cost, equating to €184 and €264 million (approx. £160 and £229 million, based on an

exchange rate of 0.87) for one-off compliance costs (assumed to be incurred in 2015 and 2016) and €112 and €211 million (approx. £98 and £184 million) for ongoing costs from 2017 onwards. As the Commission impact assessment was completed in 2011, the cost estimates have been converted to sterling at the exchange rate on the date of publication of the Commission impact assessment.

105. The UK having a 36% share of wholesale financial market activity in Europe is based on an estimate used in the Government's report on the review of the balance of competences between the UK and EU on Financial Services and the Free Movement of Capital (2014), which was provided to the review by Open Europe.

106. We note that MiFID 2 covers both wholesale and retail financial services. Retail markets are typically divided on national lines and the UK's share of retail financial services can be expected to be lower (the UK, for example, has an EU population share of approximately 12%). We have not adjusted for this as we do not have the available data.

107. In our view, apportioning a 36% share of overall EU costs to the UK can be considered to be a cautious approach. If stakeholders have further information that can improve this estimate, we would be interested in receiving these views in responses to the consultation.

108. This is the current best estimate of costs arising from the Directive. No distinction is drawn here between those costs that will fall on business as a result of legislative changes and those costs that will fall on business as a result of changes to FCA rules that together transpose the Directive in full.

109. The Commission impact assessment sets out that the main categories of compliance and administrative costs (both one-off and ongoing) are:

- investor protections;
- operating requirements; and
- transparency and reporting requirements.

110. The costs will accrue to market participants as a result of them being required to comply with regulations that go further than existing regulations they comply with. These areas and the market participants to which they apply have been set out above.

111. Under MiFID, the number of UK investment firms is 3,617. This breaks down as follows:

UK investment firms	
MiFID Activity	Number of UK firms with the permission
A1 – Reception and transmission	3,547
A2 – Execution of orders	2,213
A3 – Dealing on own account	658
A4 – Portfolio management	1,808
A5 – Investment advice	3,350
A6 – Underwriting	656
A7 – Placing	2,226
A8 – Operation of an MTF	46
Total number of UK investment firms	3,617

112. The number of UK MiFID investment firms reported above is 57% of the total number of investment firms that were reported in the Commission impact assessment (the Commission figures obviously

date from 2011 and have only been updated for the purposes of this calculation by the FCA's latest figures for UK investment firms).

113. The ESMA MiFID database shows there are 13 RMs in the UK and this is 13% of the total 104 RMs in Europe.
114. The ESMA MiFID database shows there are 74 MTFs in the UK and this is 49% of the total 152 MTFs in Europe.
115. As set out under the scope section above, these numbers can be expected to increase as a result of MiFID 2. For example, as a result of the narrowing of MiFID exemptions for those dealing on own proprietary capital or for commodity derivatives. The narrowing of the exemptions might be expected to lead to the number of UK firms authorised as investment firms under MiFID 2 to rise. Particularly given that the details of the commodity exemption have not been finalised, it is not easy to estimate how many new investment firms there will be in the UK. However, it seems unlikely that the number of firms authorised will exceed 2 percent of the total number of current UK MiFID investment firms and the actual number could be lower. APAs, ARMs and CTPs are new categories of data service providers that do not exist currently under MiFID. However, as mentioned above, the UK already has something similar to APAs and ARMs (but not CTPs) and on this basis it seems that 15 is a reasonable upper estimate of the number of data service providers likely to require authorisation in the UK under MiFID 2.
116. Overall, we expect the increase in authorised firms to be low relative to the existing number of MiFID authorised firms. The costs of MiFID 2 will predominately fall on these firms.
117. If the Government were to implement the alternative option of copying out directly MiFID 2, rather than embedding it within current UK legislation, there would be no change to the regulatory obligations on firms. However, we consider there would be an additional cost for market participants in becoming familiar with the new regime and resulting from the inherent legal uncertainty arising from a pure copy out approach.

Monetised and non-monetised costs of FCA implementation

118. The FCA is the UK's principal competent authority under MiFID, although the PRA and Bank of England also have an involvement in supervising aspects of the legislation. Implementation of MiFID 2 is likely to involve significant one-off costs for the FCA in three main areas:
- a. transaction reporting – the FCA already has a system for receiving transaction reports but this will need upgrading given the increased number of reports and significant expansion in the number of fields per report;
 - b. position reporting – whilst the FCA does periodically receive position information from trading venues at the moment it does not have a system to receive daily position reports as required under MiFID II;
 - c. transparency calculations – ESMA will require information on an annual basis for the purpose of MiFID's 2 transparency regime and the FCA will need to obtain and process the data to send to ESMA. It currently does this on a small scale under MiFID.
119. In relation to each of these items the one-off costs will significantly exceed the ongoing costs. There will be other one-off costs relating to processing applications for authorisation and variations of permission. The FCA is currently in the process of estimating the costs of its implementation project.
120. The FCA will also need to revise its Handbook to implement MiFID 2. Most of this will involve copying out European obligations or removing rules that are to be covered by directly applicable EU regulations. But there will be areas in which the FCA has an element of discretion as allowed for in the European legislation. This includes, in certain limited areas, the ability to go above and beyond the requirements in MiFID 2.
121. The FCA will consult on its policy choices towards the end of 2015 and at that time will present cost-benefit analysis where it is making discretionary policy choices.

Monetised and non-monetised costs of MiFID 2 Third Country Regime

122. The Government is not implementing the MiFID 2 third country regime, where discretion is provided in the MiFID 2 text. Therefore there are no direct costs associated with this option.
123. Although precise figures are difficult to estimate (for the reasons given below) it is likely that there would be various costs associated with implementing the MiFID 2 third country regime. These would

include the necessity of certain firms to establish branches in the UK that meet the specific requirements set out in MiFID 2. This may reduce economic activity, which is currently conducted through the UK's present regime. However, as this economic activity is conducted through certain exclusions, UK regulatory bodies do not have an exhaustive data set in relation to it. The Government will invite stakeholder comment on this aspect of the consultation.

124. Equally, there may be an opportunity cost in not implementing the MiFID 2 third country regime. If the Government was to adopt the MiFID 2 third country regime, there may be non-monetised benefits in increasing investor protection and also economic benefits in being able to rely on the EU wholesale passport (as described above). The Government will invite stakeholder comment on this aspect of the consultation.

Monetised and non-monetised costs of MiFID 2 Binary Options

125. There may be some increased costs for providers of binary options, in being regulated by the FCA. However, the Government has been advised by a range of providers of such binary options that the costs will not be considerable. We will, however, invite comment on the economic consequences of the secondary legislation in respect of binary options.
126. The option of 'do nothing' is not further considered here because it would risk the UK being in breach of its obligations under EU law.

Monetised and non-monetised benefits

127. The benefits of MiFID 2 can be considered to predominately accrue indirectly to market participants. Three key areas of benefits are set out below.
128. *Market structure and transparency.* Increased trade transparency in non-equity markets should, if appropriately calibrated under the Level 2 measures currently under development, support more efficient price formation, increased competition amongst liquidity providers and more information for investors. Increased trade transparency may have the benefit of reducing transaction costs (as set through bid/offer spreads). For example, studies of the introduction of post-trade transparency requirements in the US through the Trade Reporting and Compliance Engine (TRACE) have found evidence of reduced transaction costs post-implementation. Given differences in market structure, we have not attempted to use such studies to provide estimates of monetised benefits for the UK.
129. The introduction of a consolidated tape in both equities and non-equities should support this outcome.
130. The trading obligation in respect of derivatives may provide scope for operational efficiencies where there are currently traded bilaterally (or over-the-counter) and will in future trade on trading venues, where efficiencies of scale may be realised.
131. *Investor protection.* These requirements include placing information obligations on investment firms when offering investment services in complex products, enhanced information to be published by trading venues on execution quality and information given to clients by firms on best execution.
132. The European Securities and Markets Authority (ESMA) will provide a cost-benefit analysis of the relevant draft technical standards when it sends them to the EC in mid-2015. Its initial qualitative CBA said:

'The data required to understand implicit and explicit costs of trading is an essential metric for investment firms to monitor performance from venues, for the buy side to monitor sell side, and ultimately for the end investor to ensure they are receiving the execution quality required.'

133. The qualitative CBA said that improved best execution could have significant benefits to investors in terms of reduced costs of trading. It also suggested that the data required under MiFID 2 come at a low cost to trading venues and brokers where based on data they already have access to.

Authorisation and operating conditions

134. ESMA's high-level cost-benefit analysis of the draft technical standards mentions as potential benefits from these type of organisational requirements greater market resilience and integrity. This

may in turn lead to greater confidence in financial markets and a greater willingness to trade – enhancing liquidity and possibly reducing the costs of capital.

Rationale and evidence that justify the level of analysis used in the IA (proportionality approach)

135. The analysis and evidence is appropriate in relation to the draft secondary legislation and binary options, as the UK is under a legal obligation to transpose MiFID 2 into domestic law. We are not in the draft secondary legislation or the third country regime intending to go beyond the requirements of MiFID 2. Therefore, an analysis based on the Commission's assessment of costs and benefits is justifiable.
136. Further, as we do not in the main have policy choice over how we transpose MiFID 2, which is set in EU law, in our view our level of analysis is proportionate to the effect that this analysis would have on the costs and benefits accruing to market participants as a result of transposition.
137. In relation to the MiFID 2 third country regime the Government has considered the 'do nothing' option the most appropriate. However, the Government will consider all submissions made to it in relation to this and take account of any further data that is elicited through the consultation. The level of analysis in this impact assessment reflects this approach.
138. This is a consultation stage assessment. The Government will refine and improve this impact assessment based on feedback to the consultation and/or through further information provided to the Government separately. These improvements will be reflected in the final stage impact assessment prior to the secondary legislation being made.

Risks and assumptions

139. In drawing on the available European and UK level impact assessment's the Government has assumed the UK's share of the costs reflects its share of the European financial services industry. Estimates vary but the Government has assumed a figure of 36%, as used in the balance of competences review on Financial Services. This estimate is of the UK's contribution to Europe's wholesale financial services industry and the Government recognises that this may not accurately capture the UK's retail market and non-wholesale activities. However, it is considered a reasonable proxy figure for estimating costs associated with MiFID 2. It is equally possible that it overestimates total contribution, given that it does not take account of economies of scale. Further discussion of this assumption is provided above.

Direct costs and benefits to business calculations (following OIOO methodology)

140. As this measure involves the implementation of an EU Directive, it does not need to be counted as part of one-in, two-out. However in line with the Government's objectives, it is seeking to minimise the impact on industry where possible.

Wider impacts

Equalities Impact

141. The Government has considered its obligations under the Equality Act 2010 and does not believe these measures will impact upon discrimination, equality of opportunity or good relations towards people who share relevant protected characteristics under that Act.

Impact on small firms and micro-businesses

142. MiFID 2 will have an effect on small firms and micro-business's to the extent that they are investment firms or otherwise caught. These firms will be required to comply with the authorisation

and regulatory requirements as prescribed by MiFID 2. However, this burden is in many instances mitigated by the ability to apply the regulatory requirements in a proportionate manner to the business conducted.

Impact on competition

143. MiFID 2 seeks to increase and deepen competition in a number of financial markets. It will seek to increase economic efficiency gains and drive lower transaction and execution costs for investors. In particular, it will increase transparency in the equity and non-equity markets and drive competition amongst providers of clearing and settlement infrastructure.

Environmental, social and development impacts

144. The Government does not anticipate any impact upon greenhouse gases, wider environmental issues, health and well-being, human rights, the justice system, rural proofing and sustainable development.

Conclusion

145. The Government will consult on draft secondary legislation in relation to MiFID 2, including the transfer of supervision of binary options from the Gambling Commission to the FCA and continuing with the current UK regime in respect of third country firms.