

Consultation Response

AFME Response to CP 24/7: Payment Optionality for Investment Research

June 2024

FCA Consultation Paper: <https://www.fca.org.uk/publication/consultation/cp24-7.pdf>

Questions

1. Do you agree with our proposal to create additional payment optionality for investment research?

Yes, No, No view

AFME and UK Finance welcome the FCA's consultation on payment optionality for investment research. In principle, this is consistent with our view that the optimal regime allows buy-side firms to have the flexibility to determine how they obtain, and purchase research.

Increased optionality is an important step forward in minimising unnecessary mismatch across key geographies and ensures the UK remains competitive on a global basis. As stated in the Kent Report, 'the UK should seek to remain aligned with other key jurisdictions (in particular the US and EU) in relation to research rules, where appropriate, to avoid being at a competitive disadvantage. The UK should in any event remove any barriers which prevent UK buy-side firms from paying for investment research in other jurisdictions where payment on a bundled basis is standard practice in that jurisdiction.'

We have concerns about the proportionality and workability of the proposed optionality framework under UK rules, which are characterised by unique operational complexity.

- *The proposed COBS rules are far more detailed than relevant MiFID rules provisions in the draft EU Listing Act, or those required in the US. This may deter firms from availing themselves of the new payment option and inadvertently create cross-border frictions, rather than reduce them, as intended by the FCA. We note, for example, that one of the aims expressed in the Wholesale Markets Review is that the UK regime should be underpinned by proportionate standards that are focused on outcomes rather than prescriptive rules, enabling firms and investors to operate in the market without unnecessary frictions and costs.*
- *We believe that the substantial differences with relevant frameworks in other key jurisdictions, coupled with the additional granularity of the FCA proposed requirements will deter firms from using the new option. We note that section 26 of the cost benefit analysis states that 'the FCA survey suggested that only a minority of firms in the population of impacted buy-side firms would be interested in taking up the FCA proposals with guardrails in place.'*

Also, FCA CP 24/7 does not cater for fund managers, including UCITS managers and alternative investment fund managers, which will be dealt with in a future FCA consultation. Unless the timing of implementation is aligned for the next budgeting cycle (start of 2025), this will result in a disparity of

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treatment amongst research consumers, and firms will not be able to apply rules consistently across the franchise which will likely discourage take up of the new option.

Overall, our view is that the proposed regime is not sufficiently flexible compared to existing structures or structures available in other jurisdictions. Therefore, it lacks attractiveness. As such, it falls short of the Government's wider commitment to enhance the UK's ability to attract companies to list and to grow and does not deliver on the FCA's secondary competitiveness objective.

We believe that appropriately calibrated and proportionate rules will give the new framework the best chance of meeting its ambitions. Further details of what this may look like are given in our answer to Question 8 below.

2. Would you be likely to take advantage of the proposed new payment option?

Yes, No, **No view**

Competition law prevents AFME members from discussing this. Each individual member would need to consider whether to offer the option, based on its own community of clients and client relationships.

3. Do you have any views on key indicators that could act as success measures for the outcomes we are looking to achieve?

Possible micro-indicators could be:

- *The proportion of firms which elect to use the new payment model. Low take up would mean that the framework is not fit for purpose.*
- *The percentage of research commission paid in line with the new option.*
- *The amount of take up in the UK compared to take up in the EU.*

Possible macro-indicators of the broader health of UK markets, of which research is a component includes:

- *Number of companies listed in the UK, in particular those listed in the UK Midcap index and UK Smallcap index, excluding listed investment funds.*
- *SME research coverage and consumption.*
- *Number and growth of IPOs compared to the EU and the US.*
- *Total market cap of UK stocks compared to EU and the US.*
- *Ability to access research will increase UK competitiveness, as well as the breadth and depth of research providers utilised by UK fund managers versus international peers.*

- Amount of AUM in the UK and performance.

4. Is the proposed new payment option and associated guardrails likely to be more efficient and adaptable than existing options for small, fast-growing or new entrant firms, or for existing users of RPAs?

Yes, **No**, No view

The RPA itself suffered from low take-up due to it not being a practical instrument for most asset managers.

The new payment option is not significantly less operationally burdensome and resource intensive than the existing RPA. Thus is unlikely to be an attractive alternative to existing options for small, fast-growing or new entrant firms or some large asset managers.

5. Do the guardrails we are proposing around firms' use of the proposed payment option secure an appropriate degree of protection for consumers?

Yes, **No**, No view

The proposed UK rules are disproportionate compared to standards in other global markets. As a result, our view is that the focus on protection for consumers does not take into account the overall impact on the competitiveness of UK capital markets. Ultimately, this may lead to a position where users of investment research in the UK will continue to be disadvantaged as compared with those in other financial centres (including the US and the EU) as a result of the UK regulatory regime.

Firms are already subject to a comprehensive suite of conduct of business requirements in MiFID. Under the new Consumer Duty, firms are also required to act to deliver good outcomes for retail customers and aim to continuously address issues that risk causing consumer harm.

According to the FCA analysis, externally purchased equity research as a proportion of equity assets under management was in a range of 0.01% to 0.03% for the period 2018-2023. We consider the guardrails disproportionate to the costs involved given the other protections that are already in place and the impact that these guardrails have on the UK's ability to have a research regime that functions competitively compared to international peers such as the European Union.

In relation to the new proposals, we believe consumer protection is still achieved by an appropriately calibrated and proportionate framework as per our detailed analysis in Question 8 below.

6. Is the proposed new payment option and associated guardrails likely to facilitate operational efficiencies via increased alignment with the requirements of other jurisdictions when purchasing research from overseas providers?

Yes, **No**, No view

No. The guardrails go substantially beyond the requirements in key markets such as the US and EU, which also pursue similar objectives.

In doing so, the proposed framework seems to narrow down the new payment option to a CSA model, while combining it with RPA features. The result is a hybrid model that does not deliver operational efficiency.

Overall, the combination of the proposed safeguards produces another unbundled option that is unlikely to be attractive to UK firms because of its operational complexity.

Other jurisdictions allow for more flexibility for a completely bundled payment.

Kindly refer to our detailed answer to Question 8 below and to the comparison table annexed to our response, which highlights the several operational burdens proposed by the FCA, which do not appear to have an equivalent under applicable EU MiFID rules.

7. Do you agree with the findings set out in the Analysis section of this consultation paper?

Yes, **No**, No view

There is a general concern that the impact of the unbundling regime may have been more detrimental to the UK capital markets. We believe that, regardless of the impact of the unbundling rules, any new regime should stimulate research coverage in the UK and avoid isolation of the UK from other financial centres.

8. Are there any features of the proposed payment option and associated guardrails that would positively or negatively impact its take-up by firms?

Yes, No, No view

Overall, the combination of the proposed safeguards, while producing another unbundled option, still introduces significant operational complexity which is similar to an RPA. The resulting lack of consistency of research payment structures across key jurisdictions may ultimately result in low take

up and therefore mean that the key objectives of the HMT reforms are not achieved and that the FCA's secondary competitiveness objective is not achieved either.

The level of requirements as currently drafted will likely discourage take up and is not necessary or commensurate to protect consumers as net performance disclosure allows investors to make informed decisions:

- ***Budgeting requirements*** (COBS 2.3B.25R(5) and COBS 2.3B.26R): EU rules do not prescribe budgeting requirements. The current FCA proposals are more similar to the RPA structure (which has not been taken up). We are concerned about the budgeting and disclosure requirements at client level, which is contrary to the objective of providing a payment option which alleviates operational burdens on firms, and should be removed.
- ***Benchmarking*** (COBS 2.3B.25R(7)): the benchmarking requirement in letter (b) is problematic as mistakenly treats investment research as a commodity, without recognising that the value to customers will vary depending on their investment strategy and portfolio manager decisions, which are idiosyncratic to each firm's internal assessment. Also, the nature of the research may vary in terms of depth, scope and level of interactions. It is therefore inappropriate to require a comparison amongst different providers. This is another example of additional specificities with no clear justifications or commensurate benefit. For this reason letter (b) should be removed.
- ***Ex ante and ex post disclosures*** (COBS 2.3B.30R (3) and (5)): there will be cases in which it is appropriate to attribute research expenditure, and therefore to disclose, at firm level. The rules should make it clear that this is possible where the firm considers it appropriate given the type of research and its client base. This has been recognised in the recent EU Listing Act. Attribution at firm level will give investment managers the flexibility as to how they should disclose to their investors and mitigate operational obstacles, ensuring a proportionate and therefore more effective level of disclosure and transparency.
- ***Disclosure of the most significant research providers*** (COBS 2.3B.30R (4)): this requirement has no equivalent in other jurisdictions. It places an onus on firms, with no clear benefit, which hinders the attractiveness of the new payment option. It is not clear what benefits this commercially sensitive information would bring for end investors. Their primary interest is in an investment manager's ability to deliver investment returns, rather than needing to specifically understand which research providers the investment manager has purchased research from to make investment decisions. An unintended, and likely, consequence of this guardrail is the concentration into the largest providers, which we see as unhelpful.

Firms will need to assess different rules in different jurisdictions and make a determination as to whether to offer the new research payment option. A comparative table, looking at the difference in approach between the UK and the EU, is annexed to our response.

9. Do you agree with the proposed addition of short-term trading commentary and advice linked to trade execution to the list of acceptable minor non-monetary benefits in COBS 2.3A.19R(5)?

Yes, No, No view

Yes.

10. Do you agree with the deletion of the option for bundled payments to purchase research on companies with a market capitalisation below £200 million from the list of acceptable minor non-monetary benefits in COBS 2.3A.19R(5)?

Yes, No, No view

Our consistent position has been that the broader concept of exempting research on companies below a defined market capitalisation from the requirement to unbundle research and dealing commissions is not conducive to improving the level of research coverage on smaller companies, nor to enhancing outcomes for the UK's wider research market and capital markets ecosystem.

Furthermore, our members have noted that the rules governing investment research in the UK do not often fully reflect the way in which research is produced or consumed. Existing MiFID II unbundling requirements generally consider research to be distinct pieces of analysis on a single company. This categorisation does not reflect the fact that much of the research produced by our members on, for example, 'smaller' companies, would out of necessity include comparisons to larger companies in the same sector that do not fall below the given market capitalisation threshold.

Given this tendency for investment research to combine many different aspects of the market, creating arbitrary divisions by way of thresholds – such as the sub-£200m exemption from the unbundling rules – can be an unhelpful feature of the UK's regulatory regime which creates additional complexity and cost for those accessing research.

11. Are there any further comments you wish us to consider while finalising these proposals? If so, please include here.

Corporate Access

As previously communicated, we support corporate access being included in the new regime. Not permitting the same level of optionality as research could result in members being required to run separate payment constructs leading to additional operational complexity.

The rules have made it much harder for smaller fund managers, as opposed to larger managers, to get as much corporate access and to inform their full investment process.

Creating greater opportunities for members to directly access SMEs/corporates at events is an integral part of the investment decision making process.

This is as important as finding structures to improve availability and quality of research – therefore not addressing this consistently may reduce the overall potential benefits of the research bundling optionality.

FICC

We note in the CP that the FCA has received a number of comments pointing out confusion around how these rules operate with respect to the FICC market. We support additional efforts to clarify how the rules should operate when dealing with the FICC market.

Implementation

We support the FCA's undertaking to consult on an accelerated timeframe. However, it is equally important that the FCA has the appropriate time to consider industry feedback and that the regime delivers on the intended outcomes.

12. Do you have any comments on our cost benefit analysis?

We believe more firms will be interested in the new payment option if our comments above are taken into account.

13. Do you hold any information or data that would allow assessing the costs and benefits considered (or not considered) here? If so, please provide them to us.

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AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

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