
AFME consultation response

FCA CP21/9 Changes to UK MIFID's conduct and organisational requirements.

23rd June 2021

Introductory remarks

AFME welcomes the opportunity to respond to the FCA's CP21/9 on changes to UK MIFID's conduct and organisational requirements. We recognise the important role that these issues play in the investment eco-system and we support an examination of how this eco-system can be enhanced in the UK. Please see below our general comments and responses to the questions in the consultation paper.

We make certain observations on particular research reform proposals below. However, in respect of the overall package of proposed reform measures, AFME's members appreciate the approach the FCA has taken in proposing to create flexibility for firms, but not to prohibit or hinder existing processes which have become established since MiFID II. In particular, AFME's members encourage the FCA to consider whether under the UK's regime, to the extent it may be reformed, the industry will continue to benefit from whatever no action relief (notably from other non-EU regulators such as the SEC) may have been available under the previous rules.

Q1: a. Do you agree with our proposal to create an exemption for SME research below £200m provided the research is offered on a rebundled basis or for free? [Yes/No/No view]

Yes.

b. If yes or no, please explain your views.

AFME members consider the FCA proposals to create an exemption for SME research below £200m will affect a part of the market that as a group we are not habitually active in. From a wholesale banking perspective, the £200m threshold is unlikely to capture the vast majority of companies covered by AFME members. However, AFME members recognise that these proposals might benefit other segments in the financial markets ecosystem.

Market capitalisation threshold calculation

AFME members envisage that the rolling in time, backward looking nature of the calculation of the market capitalisation threshold would be operationally complex and therefore problematic in practice. The FCA's current proposal is to require market capitalisation to be calculated with reference to end-of-year quotes for the preceding 36 calendar months preceding the provision of research. However, AFME does not believe that the timing of the calculation should be linked to the date of the provision of service as this would make the calculations more complex.

Rather, AFME members would support refining the lookback period to be a static annual assessment at a precise date, based upon the closing price on average during the 12 months ending on 15th November, rather than a dynamic one. We would suggest an annual assessment based upon the closing price on average during the 12 months ending on 15th November each year.

We recommend this assessment date because firms typically negotiate their research arrangements on a calendar year basis, and this date would therefore allow an assessment of the universe of relevant SME shares prior to such negotiations. In an ideal world there would be a single annual list that the industry can use to identify which issuers are within the scope of the new regime.

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In addition, for newly listed companies, the lookback method will not work, therefore we suggest that for newly listed companies, the determination should be based on the market capitalisation at the close of day one trading and apply up until the date of the next re-assessment (i.e. 15th November).

AFME notes that this proposal as drafted will not be limited to payment for research for UK SME's.

AFME also notes that the regulations governing corporate access for SME companies would be unaffected by the FCA's proposals in this consultation.

Q2: a. Would you be likely to take advantage of the proposal to rebundle for SME research coverage? [Yes/No/No view]

No view.

b. If yes or no, please explain your views.

This is not something AFME members can discuss for reasons of competition law.

Q3: a. Do you agree that an Industry-led initiative to fund research would be capable of addressing low coverage of SMEs? [Yes/No/No view]

No view.

b. If yes, we would welcome your suggestions on how this can be developed. c. If yes or no, please explain your views.

AFME members consider that given the open ended nature of these proposals and the likely impact on firms and companies, members recommend a period of dedicated consultation with industry on the specificities of such a scheme.

A specific immediate concern is that depending on the nature of the funded research model and the nexus to the US, this may potentially fall foul of the US Investment Advisors Act's 1940 "special compensation rule". As mentioned, this will depend upon the model in question, but it may be challenging to devise an industry-wide initiative for certain models which does not trigger the special compensation rule.

Some AFME members believe that a sponsored research model is potentially viable and pointed to models in Switzerland and Australia. Other members are of the opinion that the existing sponsored research models have been unsuccessful in the aim of increasing coverage. The issues are complex and therefore AFME would counsel for a specific period of industry consultation prior to any rulemaking on such an initiative.

Q4: a. Do you agree with our proposal to create an exemption for FICC research? [Yes/No/No view]

No view.

b. If yes or no, please explain your views.

AFME members appreciate the FCA's efforts to seek to promote the growth and competitiveness of the UK financial service sector. Several AFME members support the FCA's proposal; some members consider there are other ways the FCA's objective could be met, and still other firms would prefer no change be made since MiFID II has already been implemented.

In addition, AFME members generally understand the FCA's proposal as providing flexibility for both the buy and sell side, meaning that firms that consider their existing arrangements satisfy the inducement rule could continue with those arrangements, while other firms would be able to amend their current arrangements

whilst still complying with the inducement rule. This approach would support the variety of perspectives that exist and will mitigate the range of firm specific impacts that will result from rule changes in this area. AFME members, however, would encourage the FCA to ensure that its approach does not compromise the availability of the SEC no-action letter relief, in line with our introductory comments.

Q5: a. Do you agree with our proposal to include research provided by IRPs in the list of minor non-monetary benefits? [Yes/No/No view]

No view.

b. If yes or no, please explain your views.

AFME concurs that this proposal would pose little inducement risk.

Q6: a. Do you agree with the circumstances in which the exemption applies i.e. where the IRP is not engaged directly or indirectly in execution services? [Yes/No/No view]

Yes.

b. If yes or no, please explain your views.

The FCA proposal works well as it applies only to those IRPs who are genuinely independent in the inducements regime context.

As per our answer to Question 5, AFME considers that this proposal would pose little inducement risk.

Q7: a. Do you agree with our proposal to include in the list of minor non-monetary benefits openly available written material? [Yes/No/No view]

Yes

b. If yes or no, please explain your views.

AFME members support the FCA proposal to explicitly enshrine existing guidance/practice by including in the list of minor non-monetary benefits written material that is made openly available from a third party to any firms wishing to receive it or to the general public. We welcome the FCA making it clear that the proposal applies to all publicly available content (rather than solely macro-economic content).

Current UK market practice for “openly available” research

AFME members report that it is current market practice in the UK to allow openly available research (subject to the FCA 2018 guidance as described below and in the attached minute) to be distributed free of charge. AFME members would encourage FCA to make its 2018 guidance more widely available, perhaps by slightly amending the proposed new Handbook text as follows:

COBS 2.3A.19(5)(j) R written material that is made openly available from a third party to any firms wishing to receive it or to the general public. “Openly available” in this context means that there are no conditions or barriers to accessing it, for example requiring a log-in, sign-up or submission of user information by a firm or a member of the public in order to access that material, other than those necessary to enable the third party to comply with relevant laws and regulations.

Reasoning for clarifying the definition of “openly available” research

AFME members suggest this change to reflect the guidance given by FCA on 3rd May 2018, on the basis of which many UK firms have made their arrangements.

FCA 2018 guidance on “openly available” research

In that meeting, the focus of the discussion was on the FCA’s interpretation of changes made by ESMA to its Q&A (8) on investor protection and intermediaries topics published on 23 March 2018¹. In the revised version of Q&A (8) on macroeconomic analysis (within Section 7 (Inducements (research)) of the ESMA Q&A), in a similar vein to the FCA proposed text in CP21/9:

“ESMA considers that ‘openly available’ in the context of written material should mean that there are no conditions or barriers to accessing it, for example a necessary log-in or sign-up, or the submission of user information by a firm or a member of the public, in order to access material.”

The FCA provided oral assurances that filtering may be required “in certain situations”. The FCA added that for research material to be openly available within the “spirit” of ESMA’s Q&A, the FCA expects distribution to be “as frictionless as possible”, while complying with applicable legislation. AFME members raised with the FCA examples of rules, both UK and foreign, that would require firms to be vigilant as to who receives certain types of research. The FCA confirmed that using logins or otherwise restricting access solely to comply with other legal obligations such as, for example, the UK financial promotion rules, does not mean that the written material accessible via such log-ins is not openly available. Given that, today as in 2018, PERG 8.12.6G refers to password-protected access to information as one way of controlling who may access a financial promotion, it would be very important for the FCA to restate its view that where access is restricted exclusively to comply with legal obligations, it still qualifies as openly available.

The FCA also noted that, in their view, making content publicly available as outlined above leads to the content ceasing to be considered substantive, thereby removing the inducement risk. This does not just apply to macroeconomic or FICC research (as per ESMA’s Q&A 8 and 9) but could equally apply to equity research and to less substantive sales and trading commentary, which is made openly available.

Q8: a. Do you agree with our proposal to remove the obligation for execution venues to produce execution quality reports consistent to the format prescribed under RTS 27? [Yes/No/No view]

Yes

b. If yes or no, please explain your views.

AFME supports the FCA’s proposal for a removal of RTS 27 and RTS 28 best execution reports as a relief measure given that these reports are burdensome to members and offer little or no benefit to end investors. AFME agrees with the FCA’s suggestion that the production of the reports by investment firms is highly costly and that ultimately end investors must bear these increased costs whilst receiving very limited value from them.

Q9: a. Do you agree with our proposal to remove the obligation for execution venues to produce execution quality reports consistent to the format prescribed under RTS 28? [Yes/No/No view]

Yes.

b. If yes or no, please explain your views.

¹ <https://www.esma.europa.eu/document/qas-mifid-ii-and-mifir-investor-protection-topics>

AFME supports the FCA's proposal for a removal of RTS 27 and RTS 28 best execution reports as a relief measure given that these reports offer little or no benefit to end investors. AFME agrees with the FCA's suggestion that the production of the reports by investment firms is highly costly and that ultimately end investors must bear these increased costs whilst receiving very limited value from them.

In addition, AFME members believe that it may be helpful if the FCA considered issuing a forbearance statement for compliance with RTS 28 reporting, similar to the statement that was published on 19 March 2021 for RTS 27 reports and 10% depreciation notifications once the FCA has made its final decision whether or not to abolish RTS 28 reporting. In its March 2021 statement, the FCA noted that RTS 27 reports were of limited value to users but carried a high burden on firms in producing them. Therefore, while the FCA considered their possible abolition, it stated that it would not expect firms to comply with RTS 27 during 2021.

A similar justification for forbearance also appears to exist for RTS 28 reports, as the FCA has highlighted in its consultation that market participants do not find the outputs from RTS 28 reports helpful in scrutinising best execution or deciding which brokers to use.

While the next RTS 28 reports are not due until April 2022, operationally, RTS 28 record capture is ongoing for every business day throughout the year, effectively commencing on the 1st of January and completing on 31st December. Some firms also have a validation process, whereby interim reports are produced to enable results review ahead of the annual exercise. Bearing in mind that there is likely to be a period of time between the FCA making its final policy decision and the effective date of any changes, AFME believes it would be helpful if the FCA could make a timely forbearance statement shortly after it has made its policy decision (assuming it decides to abolish RTS 28 reports) as this would help to alleviate the burden on firms to continue to prepare for these reports pending the finalisation of the rules.

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