

IA response to FCA CP24/7: Payment Optionality for Investment Research

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.8 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 48% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

The IA is pleased to respond to the FCA's Consultation Paper 24/7: Payment Optionality for Investment Research. Investment research forms a critical part of the investment process for our members, helping to ensure that investment managers can make well-informed improvements on behalf of their end clients.

To this end, last year we welcomed the Investment Research Review's efforts to enhance the competitiveness and coverage of the research market in the UK, in order to help provide access to high quality research. As a key component of that work, we also welcome the FCA's consideration of the issue of payment optionality for research. This is an important area of focus for our members, and last year the IA published a position paper setting out what we saw as the key features of any payment optionality regime. Our response draws from that paper, as well as incorporating additional comments from our members responding to the specific questions and proposals raised by the FCA.

The IA is supportive of research payment optionality, which will provide investment managers with the flexibility to choose the payment option that works best for their business and clients.

We believe this flexibility should extend to investment managers' approach to the guardrails, and that the FCA should, within the criteria set out, allow firms to determine policies on issues such as budgeting, cost allocation, benchmarking and valuations in a manner that is most appropriate to them and their clients. This includes being able to set the level at which these policies would apply at whatever level firms deem appropriate. It is important that the guardrails not be overly prescriptive, as this could preclude firms from being able to take up the new option. This flexibility will be essential in order for asset managers to revert to a global research programme (covering the UK, US, and Asia Pacific).

It is worth highlighting that clients ultimately select investment managers based on net performance vs net costs (which research costs form a part of). To the extent that research costs and the basis on which these are determined, valued and allocated are clearly disclosed to clients this should provide them with the tools necessary to assess whether continuing to engage the services of an investment manager is in their best

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interests, without the need for the FCA to take a more prescriptive approach than other jurisdictions which is likely to inhibit the uptake of the payment optionality.

We do note that any decision as to whether to take up the proposed new payment mechanism would be dependent on the business model and approach of individual member firms, and would be taken only after careful analysis and engagement with clients. Transition to a new payment model would also require time and resource to implement and transition to necessary new systems.

Ultimately, we would stress that while policy makers and regulators should not necessarily expect an immediate large-scale industry switch to a new approach to research payments, we believe that providing investment managers the flexibility to implement the research payment choices that work best for them and their clients will produce the best outcome.

The IA notes that these proposals are at this stage limited to COBS 2 and do not extent do similar changes being applied to COBS 18. We note that for any significant take-up of research payment optionality to take place COBS 18 will also need to be amended in line with COBS 2, and we welcome the FCA's statement that it will look to achieve this alignment in a future consultation.

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

The IA is supportive of the FCA's proposals to create additional payment optionality for research.

Many of our members see significant potential benefits in taking up the new payment option. These include:

- Potentially reducing direct costs to investment managers, particularly benefitting smaller investment managers and reducing barriers to entry.
- Improved alignment with the requirements of other jurisdictions, such as the US and EU, increasing operational efficiencies.
- Reduces operational complexity compared to current alternative research payment mechanisms such as the RPA.

Nonetheless, a number of our members have also expressed support for the current approach to research payments, as well as downsides to the new payment option. These include:

- Potential higher costs for clients.
- Potential costs for investment managers in terms of implementing new operations and mechanisms for managing this process.

Given the range of views, the IA is supportive of payment optionality, which will provide investment managers with the flexibility to choose the payment option that works best for their business and clients. We believe this flexibility should extend to investment managers' approach to the guardrails, and that the FCA should, within the criteria set out, allow firms to determine policies on issues such as cost allocation, benchmarking and valuations in a manner that is most appropriate to them and their clients. This includes being able to set the level at which these policies would apply at whatever level firms deem appropriate. It is important that the guardrails not be overly prescriptive, as this could preclude firms from being able to take up the new option.

The IA's membership has expressed diverse opinions as to whether, and when, they are likely to transition to any new payment methodology. For this reason regulators and policy-makers should not necessarily expect that there will be an immediate large-scale industry switch to a new approach to research payments, or any immediate increase in research budgets or consumption.

The IA notes that these proposals are at this stage limited to COBS 2 and do not extent do similar changes being applied to COBS 18. We note that for any significant take-up of research payment optionality to take

place COBS 18 will also need to be amended in line with COBS 2, and we welcome the FCA's statement that it will look to achieve this alignment in a future consultation.

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

As noted in our response to Q1 we have heard a wide range of views from our membership as to the likelihood of their taking advantage of the proposed new payment option, and the timeline on which they would look to do so. Any such decision would be dependent on the business model and approach of individual member firms, and would be taken only after careful analysis and engagement with clients. Transition to a new payment model would also require time and resource to implement and transition to necessary new systems.

Ultimately we would stress that while policy makers and regulators should not necessarily expect an immediate large-scale industry switch to a new approach to research payments, we believe that providing investment managers the flexibility to implement the research payment choices that work best for them and their clients will produce the best outcome.

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

A primary driver of these proposals has been the desire to improve research coverage of SMEs. A key indicator of success will therefore be the extent to which these proposals do lead both to up-take of the newly proposed research payment mechanism and to increased coverage for these companies, though we note that the recommendations of the Investment Research Review form just one part of a wider range of reforms being proposed with regard to enhancing the competitiveness of the UK market as an environment for companies to grow and operate.

The FCA should avoid looking at simplistic indicators such as an increase in research spend, which would not necessarily be reflective of value or 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 firms or new entrant firms, or for existing users of RPAs?

As noted in our response to Q1, due to the overall size of a research budget having it paid via P&L can be a barrier to entry for smaller firms. Being able to spread the cost, at a minimal charge to clients, may be beneficial for startup or smaller firms in the investment management market, thus driving innovation and competition.

The proposed new payment option seemingly is likely to be less operationally burdensome and resource intensive than the existing RPA model and should hopefully be cheaper and easier to administer. It should be noted however that if there is limited take-up of the new model by existing firms and a significant proportion of the established market continues to pay for research out of P&L, it may also make it difficult for new entrants to the market to adopt, as this approach could be seen as a negative differentiator by clients.

Investment managers currently using the RPA model would be well-placed to take up the new payment option. This would be dependent on new rules not being overly prescriptive however. For example, prescriptive, UK-specific requirements could preclude investment managers from reverting a global research payment model. In that case there may be no benefit to those firms in moving away from the RPA model. As noted in our response to Q1, to maximise take-up the FCA should, within the criteria set out, allow firms to determine policies on issues such as budgeting, cost allocation, benchmarking and valuations in a manner that is most appropriate to them and their clients. This includes being able to set the level at which these policies would apply at whatever level firms deem appropriate.

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

The IA considers that the proposed guardrails provide sufficient consumer protection.

Furthermore, we believe the current proposal requiring firms to disclose the most significant research providers, and the benefits and services received from such providers, is overly onerous and will not provide much benefit to end clients. The inclusion of this requirement was initially linked to best practice pre-MiFID II. However, on further review we believe it may no longer be particularly useful. The list of most significant research providers may change on a regular basis and is likely to be materially similar from firm to firm (given a limited number of major research providers) while failing to distinguish between the types of research services being offered. As such, any such list would likely provide only a snapshot view to clients which is unlikely to provide any meaningful information. It also potentially creates a requirement that is misaligned with other jurisdictions, making harmonisation more difficult.

As noted in our response to Q1, it is important that the FCAs approach to the guardrails not be overly prescriptive, and that firms should have the ability to determine policies on issues such as cost allocation, benchmarking and valuations in a manner that is most appropriate to them and their clients. This includes being able to set the level at which these policies would apply at whatever level firms deem appropriate. Otherwise, some firms may find it challenging to take up the proposed new payment methods dependent on their own internal processes and business model.

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?

The IA considers a significant potential benefit of payment optionality to be allowing greater alignment with research payment requirements in other jurisdictions, particularly the US and EU. It is important the rules are therefore not so onerous that they do not practically align with US or EU rules.

We do note that the guardrails set out by the FCA are more prescriptive than the more high-level requirements set out by the EU, the US and in many jurisdictions in Asia.

We have received a range of views from members as to whether this would lead to operational difficulties. Some firms consider that the differences are sufficient that it would make implementing a harmonised approach across jurisdictions difficult, thus removing one of the key potential benefits of payment optionality. For example, as noted in our response to Q5, a number of IA members stated that the requirement to disclose a list of significant research providers was out of step with requirements in the US.

Other firms acknowledge the differences between the frameworks but consider that alignment could still be achieved by operating a single global model which applies the more stringent elements of these frameworks while still allowing them to align with the others.

Given the range of views, to promote broader adoption and avoid creating jurisdictional barriers, the IA again stresses that it would be prudent to adopt a flexible approach to the framework.

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

The IA does not have further comments on this section.

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

As mentioned in our response to Q1 and Q2 we have heard a wide range of views from our membership as to the likelihood of their taking advantage of the proposed new payment option, and the timeline on which they would look to do so. Any such decision would be dependent on the business model and approach of individual member firms, and would be taken only after careful analysis and engagement with clients. Transition to a new payment model would also require time and resource to implement and transition to necessary new systems.

As also noted in our response to Q1, it is important that the FCAs approach to the guardrails not be overly prescriptive, as to do so may preclude some firms from taking up the new research payment mechanism.

For example, we note that in the proposed amendment language for the Conduct of Business sourcebook, there is a requirement that budgets, cost allocation, and disclosures on significant research providers be set at “an appropriately aggregated level (eg. for similar investment strategies or groups of clients who benefit from the same research)”. For this framework to be successful, it is vital, given the differing commercial models of investment managers, that firms have the flexibility to determine the appropriate level at which these are set.

As noted in our response to Q5, we believe the current proposal requiring firms to disclose the most significant research providers, and the benefits and services received from such providers, is overly onerous and will not provide much benefit to end clients. The list of most significant research providers may change on a regular basis, meaning any such list would likely provide only a snapshot view to clients which is unlikely to provide any meaningful information.

As noted in our response to Q1, the IA notes that these proposals are at this stage limited to COBS 2 and do not extend to similar changes being applied to COBS 18. We note that for any significant take-up of research payment optionality to take place COBS 18 will also need to be amended in line with COBS 2, and we welcome the FCA’s statement that it will look to achieve this alignment in a future consultation.

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, we believe this will help with increased alignment with other jurisdictions. It will also facilitate discussions with brokers, and the trading process, to the benefit of end consumers.

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, the IA is supportive of this proposal which simply reflects that bundled payments will now be an option for research on all companies, not just those under the threshold.

11. Are there further comments which you wish us to consider while finalising these proposals?

We note that wording relating to corporate access is being retained. We acknowledge the FCA’s statement that it will be considering corporate access, as well as fixed income research, at a later date and would welcome further engagement on those topics at the appropriate time.

Several of our members have suggested that an industry-led Code of Conduct would be helpful for investment managers in ensuring that they are meeting expectations and to help end-investors make informed decisions.

Finally, the IA encourages the FCA, upon deciding on new rules and ahead of implementing them, to engage closely with the market to ensure investment managers are aware of the full details of the new requirements and the FCA's expectations with regard to policies.