FINANCIAL CONDUCT AUTHORITY

Policy Statement

PS24/9

Payment Optionality for Investment Research

July 2024

This relates to

Consultation Paper 24/7 which is available on our website at www.fca.org.uk/publications

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Contents

Chapter 1

Summary

Our consultation

1.1 In April 2024, we published Consultation Paper 24/7 (CP24/7), 'Payment optionality for investment research'. CP24/7 proposed changes to the existing rules governing how payments for investment research are made. It proposed a new option, which would enable firms such as asset managers who wish to buy investment research to use joint payments for third-party research and execution services, provided that the firm meets the requirements in relation to the operation of these. This option would exist alongside those already available, such as payment from an asset manager's own resources, and payment from a dedicated research payment account (RPA) for specific clients, thereby allowing firms additional flexibility.

1.2 Investment research plays a crucial role in providing analysis and forecasts to potential and existing investors. Historically, brokerage firms typically "bundled"[1] research costs with execution commissions (i.e. the cost charged to clients to trade in shares). MiFID II introduced requirements to separate charges for execution and charges for research, thereby "unbundling" these two services. Firms were required to either pay for research themselves from their own resources (P&L model) or agree a separate research charge with their clients (RPA model). In July 2023, the Investment Research Review (IRR) set out a series of recommendations to improve the investment research market, including creating an option for paying for research using combined payments for trade execution and research. CP24/7 arose from the FCA's consideration of that recommendation, and this Policy Statement (PS) arises from our consideration of responses to that CP.

Summary of feedback and our response

1.3 We received and considered 44 responses to CP24/7. Those responses represented a range of interests, including trade associations, asset managers, brokers, independent research providers (IRPs), research services companies, and professional services firms (see Annex 1). We also received responses from two FCA panels, representing consumer and small business interests, which are covered under 3.19 and 3.30. We thank those who responded to our consultation, and we look forward to continuing engagement with market participants and trade associations that has underpinned our approach so far.

1.4 Overall, the feedback we received to our proposals was broadly positive. Respondents welcomed our policy approach and generally showed a strong level of support for the

1 Throughout this PS we use the term "joint payments" to refer to the option specifically presented in this paper and use the term "bundled" payments when referring to other approaches that typically differ from the option finalised in this paper or when relaying industry views that use the term in a looser sense (as explained in our response to Q4). We occasionally use the term "combined" payments when a more general meaning is intended that does not precisely match either of these. This is to provide greater precision, and to reflect feedback on differences between industry and FCA use of the terms "bundled" and "unbundled" in CP 24/7.

introduction of a new joint payment option, though some raised concerns about the precise specification of certain accompanying guardrails.

- Where firms supported the new option but objected to some of the requirements attached to it, as presented in CP24/7, it was typically due to perceived challenges around budgeting, price benchmarking, research provider disclosures and cost allocation and disclosures. Respondents wanted more latitude around how certain guardrails are implemented by different types of firms (budgeting, cost allocation and disclosure), a focus on outcomes rather than specifying specific means of achieving such outcomes (price benchmarking), and less detailed firm-specific disclosures (research provider disclosures). We have considered the feedback and have made amendments in relation to these requirements in our final rules.
- In other cases, firms were undecided because they had not yet undertaken the necessary commercial analysis to assess implementation costs and benefits, or had a business model in which they preferred to continue with existing options (in particular, payment from own resources).
- The majority of respondents that supported the proposal underpinned their views with its potential benefits from the perspectives of competition, market integrity and international competitiveness and growth. Such respondents also generally believed that the guardrails meant that any potential consumer protection harms were sufficiently mitigated. The minority of respondents that did not support the introduction of the new option (whether this particular design or more generally) emphasised consumer protection concerns. Conversely, those supporting the option generally asserted that consumer protection had been either sufficiently or even disproportionately emphasised in design of the option proposed.

1.5 Of those respondents that expressed a view, there was a very substantial majority in support of the other changes proposed in our CP, i.e.

- the addition of short-term trading commentary and advice linked to trade execution to the list of acceptable minor non-monetary benefits (MNMBs) in the Conduct of Business sourcebook (COBS);
- the deletion of the option for combined payments for research and trade execution to purchase research on companies with a market capitalisation below £200 million from the list of acceptable MNMBs in COBS.

1.6 This PS summarises the feedback received on CP24/7 and outlines our final policy position and Handbook rules. The changes to the research rules will come into force on 1 August 2024. We discuss these areas of feedback in further detail in the relevant sections below.

1.7 We received feedback on several points that did not specifically relate to the policy changes proposed in CP24/7. Some of the feedback received was relevant to the definition of investment research. Other areas of feedback were in relation to aspects of our rules that we had not proposed changing at this stage. This additional feedback will not be addressed in this PS. These included, for example:

- Inducement rules covering corporate access;
- Inducement rules around access to new research providers, e.g. the three month trial window;

- The treatment of fixed income, currency and commodities (FICC) research within the current inducement rules;
- Retail access to investment research;
- The status of macro investment research;
- An industry code of conduct for sponsored research, and recognising sponsored research as investment research.

Who this affects

1.8 Our final rules will affect:

- Investment firms and market operators in the UK;
- Asset managers;
- Institutional investors such as pension schemes;
- Insurance firms;
- Banks providing investment services;
- Persons providing research that we do not authorise.

1.9 The policy intention is to make further changes that ensure consistency across all the rules on research and inducements for investment firms and collective portfolio managers. To achieve this, we are aware that the changes we are making in this PS should also apply to fund managers, including UCITS managers and alternative investment fund managers under COBS 18. The changes we are introducing to the list of acceptable MNMBs in COBS 2.3A and the addition of payment optionality in COBS 2.3B are not at this stage mirrored in changes to COBS 18 Annex 1 relevant to:

- UCITS management companies;
- Full-scope UK Alternative Investment Fund Managers (AIFMs);
- Small authorised UK AIFMs and residual Collective Investment Scheme operators.

1.10 We plan to set out the necessary rule changes to achieve this alignment in a future consultation and will do so shortly in the autumn. Our intention is to make the same option available in substance, and we will over the coming period consider technical aspects of how best to achieve this in practice.

The wider context of this policy statement

Our consultation

1.11 CP24/7 proposed rule changes that aim to provide additional flexibility to investment firms in choosing how to pay for investment research. These changes form part of wider reforms to strengthen the UK's position in global wholesale markets. The IRR, commissioned by the government, set out a series of recommendations to improve the investment research market. CP24/7 and this PS arise from the FCA's consideration of Recommendation 2 in the IRR, namely creating an option to pay for investment research where the payments for research and trade execution are combined.

1.12 The additional flexibility that our rule changes are aiming to introduce share common features with other jurisdictions, including the US and the EU. Further information can be found in CP24/7.

How it links to our objectives

Competition

1.13 The changes being implemented should advance our competition objective by promoting effective competition for asset management services among asset managers for the benefit of investors, and improving the ease with which new entrants can enter this market. Evidence and external engagements prior to publication of our CP indicated that RPAs are primarily used by smaller firms with less ability to absorb research costs. (Responses to our CP highlighted that some larger firms may also use RPAs, although their use may be less extensive among such firms). Firms have highlighted that operating RPAs is resource intensive and can be operationally complex. As such complexities and resource demands have a proportionally larger impact on smaller firms, and as such firms may have more limited own resources with which to pay for research, this can put them at a competitive disadvantage. We also found that smaller firms currently utilising the RPA model may be most interested in taking up the new payment option.

Consumer Protection

1.14 The changes to introduce the new payment option have guardrails to ensure that the additional flexibility for firms does not come with undue costs or harms to consumers. The guardrails are there to ensure sufficient discipline in such areas as budgeting for research spending, assessing the value of research purchased, fair allocation of costs among clients, transparency and disclosure to clients, and preserving best execution requirements unchanged. We believe the features of the new option have sufficient levels of discipline and transparency to secure an appropriate degree of protection for consumers.

Market Integrity

1.15 The changes may also advance our market integrity objective, though the benefits in this case are less certain. The changes could lead to an increase in the amount and breadth of research purchased by UK asset managers, which could improve information availability to them. Increased information availability could, in turn, have a positive benefit on UK equity market functioning. It is more likely that the benefits to this objective will be indirect and with respect to asset managers (e.g. enhanced understanding of new sectors, business models and product innovations) than direct and with respect to overall UK equity market functioning (e.g. liquidity levels). In CP24/7 we concluded that the impact of the changes on market integrity should be neutral or marginally positive, but with a lesser evidence base. Evidence submitted by respondents to our CP, and covered in more detail below, provided some evidence for

reduced research availability and declining analyst coverage levels in UK capital markets. However, there was less evidence on the causal link between this and the change in payment options available under MiFID II.

Secondary International Competitiveness and Growth Objective

1.16 FSMA 2023 implements the outcomes of the HM Treasury's Smarter Regulatory Framework (SRF) Review and makes important updates to the UK's framework for financial services to reflect the UK's new position outside of the EU. FSMA 2023 also introduces a new secondary international competitiveness and growth objective for the FCA.

1.17 When advancing our primary objectives of consumer protection, market integrity and effective competition in the interest of consumers, we have a secondary objective to facilitate the international competitiveness of the UK economy, and its medium to long term growth, subject to aligning with relevant international standards.

1.18 When considering the design of the new payment option we have had regard to payment structures that operate in other jurisdictions, for instance commission sharing arrangements (CSAs), as detailed under 2.7. We have aimed, where possible, to have key features of the new payment option that are adaptable and compatible with those of other jurisdictions. This includes avoiding the creation of any direct conflicts of requirements across different jurisdictions to help limit the impact of compliance costs for firms, and ensuring that where requirements differ from those of other jurisdictions there are sufficient grounds to do so. We believe that the new payment option will facilitate asset managers accessing research globally, making UK asset managers better able to compete on an international scale. We will keep international developments under review in future years, given a key intent of our changes is to ensure the interoperability of this new option with payment models in other jurisdictions.

What we are changing

1.19 The option we are introducing facilitates joint payments for third-party research and execution services, provided that the firm meets the requirements in relation to the operation of this. We set out a summary of these key requirements below.

- A written policy describing the firm's approach to joint payments, including with respect to governance, decision-making and controls.
- An arrangement that stipulates the methodology for calculating and separately identifying the cost of research.
- A structure for the allocation of payments between research providers, including IRPs.
- An approach for the allocation across clients of the costs of research purchased through joint payments, appropriate to the investment process, product, services and clients of such firm, but ensuring its outcome is fair, such that the relative costs incurred by clients are commensurate with relative benefits received.
- Periodic assessment of the value, quality, use and contribution to investment decision-making of the research purchased, and how the firm ensures that

research charges to clients are reasonable against relevant comparators, to be undertaken at least annually.
- Disclosure to clients on the firm's approach to joint payments, including for instance if and how joint payments are combined with any other payment option, the most significant research services purchased, and costs incurred.
- Operational procedures for the administration of accounts used to purchase research, and for the delegation of such responsibilities to others.
- A budget to establish the amount needed for third-party research, reviewed and renewed at least annually, and based on expected amounts needed to purchase such research as opposed to volumes or values of transactions.
- It is confirmed that research services are not a factor in assessing best execution, and the best execution rules of COBS 11.2 continue to apply unchanged.

1.20 This new option will exist alongside those already available, i.e. payments for research from a firm's own resources and payment for research from an RPA for specific clients. We are not seeking to change the existing rules on these other payment options.

1.21 Our changes to the rules include adding short term trading commentary and advice linked to trade execution to the list of acceptable MNMBs for all payment options to COBS 2.3A.19R(5). Our engagement with market participants highlighted challenges facing UK asset managers receiving research from US firms that are registered both as broker-dealers and investment advisors. Although our consultation focused on introducing a new payment option for research, and not on reassessing the scope of eligible research services, the linkage of such services with trade execution justified introducing the amendment.

1.22 We are deleting the rule relating to investment research on small and medium enterprises (SMEs) in COBS 2.3A.19R(5)(g). This option for combined payments to purchase research on companies with a market capitalisation below £200 million, which was introduced through PS21/20, has had little take-up. Furthermore, the new option for joint payments can apply to research on companies of any size, including the companies captured by these provisions we are now deleting. However, we are retaining COBS 2.3A.19R(5)(h) to (k) that were also added through PS21/20, which includes treating corporate access in relation to companies with a market capitalisation below £200 million as an acceptable MNMB.

1.23 Following careful consideration of the feedback we received from our CP, we have also made the following changes, compared to the version we consulted on in CP24/7.

- **Budgeting:** In the consultation we provided examples of how budgeting could be done at the level of an investment strategy or group of clients. We have now clarified in our rules that there is flexibility to accommodate a level of aggregation that is appropriate to a firm's investment process, products, services, and clients. We now also specify that disclosures on budgets being exceeded should be made as soon as reasonably practicable, and can be part of a firm's next periodic report on costs and charges. Previously our requirements had specified that such disclosures be made within that research budget period, and it was interpreted by some respondents that they should be a separate communication to clients.

- **Research provider disclosures:** We have amended this guardrail in two ways. First, it no longer requires the disclosure of the most significant research providers. We have replaced this with a requirement to disclose instead the types of providers from which research services are purchased, accompanied by guidance clarifying that a breakdown according to IRPs vs non-IRPs is one way of meeting this requirement. Second, we have amended the level of aggregation at which such disclosures are to be made, to mirror those of the budgeting guardrail above (i.e. appropriate to a firm's investment process, products, services, and clients). These changes address concerns about providing information that may be either uninformative or commercially sensitive, while still requiring disclosure on the principal services and the broad categories of providers on which clients' monies are spent. The changes also address a number of responses proposing increased disclosure on the proportion of research procured from IRPs, while providing sufficient latitude by embedding this in guidance. We also clarify some points where our proposals in CP24/7 were potentially misinterpreted (e.g. the requirements do not necessitate disclosure of actual amounts paid to research providers).
- **Price benchmarking:** Our consultation proposed a requirement to undertake benchmarking of prices paid for research services against relevant comparators to ensure charges to clients are reasonable. We have amended this to require that firms ensure research charges to clients are reasonable, whilst guidance clarifies that benchmarking of prices paid for research services is one means of demonstrating compliance. We believe this is a proportionate approach, focusing on the outcome we are seeking to achieve, but also indicating an approach that can enable firms to meet the requirements, while providing latitude for other approaches.
- **Cost allocation and disclosure:** We have amended this guardrail in two ways. First, on fair allocation of costs, we have provided latitude about the levels at which costs are allocated, provided these are appropriate to a firm's investment process, products, services, and clients. This provides similar latitude as the modified budgeting and research provider disclosure guardrails above. Second, we have given more flexibility on how to estimate expected annual costs to clients. Previously we had been more prescriptive, but asset managers can now calculate it according to which of two methods is most appropriate.
- **Separately identifiable research charges:** We have made a lesser change to the wording of how research costs are to be separately identified within joint payments for research and trade execution. We previously required that there be written agreements with research providers. We now more broadly require that arrangements be in place that stipulate how this is done. This accommodates a broader range of potential market practices and arrangements: both bilateral between firms and multilateral with service providers; both physically and electronically documented; or both as negotiated agreements and via standard terms of business.

Outcome we are seeking

1.24 The outcomes we are seeking are to:

- Promote effective competition among asset managers by introducing a new payment option that is more operationally efficient than RPAs, and may thereby improve the ease with which new entrants can enter the market and be more scalable for small but fast-growing firms.
- Facilitate the international competitiveness of UK asset managers, by introducing an option whose features are compatible with those that operate in other jurisdictions, and providing operational efficiencies for asset managers with diverse business models to purchase research across multiple jurisdictions.
- Securing an appropriate degree of protection for consumers through guardrails to ensure sufficient discipline around such areas as budgets for research spending, fair allocation of costs to clients, value assessment; ensure charges to clients are reasonable; and ensure transparency on the firm's approach and its outcome to clients.
- Preserving the aspects of research procurement approaches introduced under MiFID II that have been beneficial and operated as intended.
- Increasing choice and avoiding unnecessary regulatory costs, by introducing a new option while keeping existing options unchanged.

1.25 Overall, it is envisaged that if the new option is taken up by firms, the additional flexibility offered by the option will lead to a reduction in the frictions they face when accessing research (particularly when accessing research from overseas jurisdictions). This should have the causal effect of lowering research procurement costs for asset managers, and improve competitiveness amongst small, fast-growing and new entrant firms, especially those using RPAs, and avoid placing asset managers at a competitive disadvantage globally. There may also be an increase in the amount or breadth of research purchased, such that investors gain other benefits, for instance an enhanced understanding of new sectors, business models and product innovations.

Measuring success

1.26 Our survey data in CP24/7 indicates that asset managers largely receive the research they need, but that it can sometimes be operationally complex for them to do so. The aim behind our rule changes is to introduce a payment option that is operationally efficient and adaptable to firms of different business models and sizes. In advancing our secondary objective, we have sought to make the new option compatible with rules and practices regarding payments for research in other jurisdictions, in order to better facilitate asset managers buying research in the same way across borders. We believe that a three-pronged approach to measuring success is most appropriate:

- take-up of the new option;
- positive changes in trends of research production and consumption;
- verification that this has not been achieved via undue costs or harms to consumers.

1.27 These could be measured by a survey that builds on the types of data and information that were previously surveyed on to inform our CP. We would undertake that survey after a reasonable period of time, and would compare the results versus the original survey. For further detail, see responses to Q3 below.

1.28 As we said in our Strategy for 2022-2025 and the associated Business Plans for 2022/23 and 2023/24, we will use a variety of metrics to monitor and assess whether our work and actions more generally and taken as a whole are strengthening the UK's position in global wholesale markets. Regulation is not necessarily the key driver in the markets for investment research and asset management services, and we recognise that macro-economic and other capital markets factors can have significant impacts on trends in these markets. Nonetheless, over time, we aim to consider the impact of our changes and their success by monitoring the size and breadth of the UK asset management market, as well as size of assets under management relative to other jurisdictions.

1.29 In line with our Rule Review Framework, if we find that the problems originally identified are still occurring and our remedies have not had the intended effect, or had an unintended effect, we will consider whether to take further action.

1.30 Other measures of success include an increase in the perceived effectiveness of our role and impact in regulation of the wholesale markets and other metrics, as described in our Annual Report published metrics.

Equality and diversity considerations

1.31 We have considered the equality and diversity issues that may arise from the rule changes in this PS.

1.32 Overall, we do not consider that the changes materially impact any of the groups with protected characteristics under the Equality Act 2010.

Implementation and next steps

Implementation period

1.33 Our aim is to implement the new rules by 1 August 2024. As what we are introducing is a new option, firms themselves can determine both whether and when they wish to avail themselves of it after this point. This date consequently makes it available on a timely basis to those market participants that wish to do so, while allowing others sufficient time to determine if and when they wish to do so.

What we will do next

1.34 We aim to consult shortly in the autumn on updated COBS 18 rules to reflect the new rules in COBS 2.3B to ensure consistency across the different regulatory regimes.

What you need to do next

1.35 From 1 August 2024 onwards, if you wish to take up the new payment option, you will need to ensure that you comply with our requirements and that you have updated your internal procedures. You should therefore ensure that sufficient measures are taken to facilitate familiarisation with our new requirements.

Chapter 2

The wider context

Legislative framework

MiFID II

2.1 The UK Markets in Financial Instruments Directive (UK MiFID) is the collection of laws that regulate the buying, selling and organised trading of financial instruments. The rules are derived from European Union (EU) legislation that took effect in November 2007 and were revised in January 2018 (MiFID II).

2.2 MiFID II introduced requirements to separate charges for execution from charges for research, thereby "unbundling" these two services. Firms receiving research were required to either pay for research themselves from their own resources (P&L model) or agree a separate research charge with their clients (research payment account, or RPA model). The policy objectives of the MiFID II reforms were to manage conflicts of interest, improve accountability over costs passed to customers, and improve price transparency for both research and execution services. The MiFID II requirements were incorporated into the UK rules on inducements in COBS 2.3 and COBS 18.

CP 21/9

2.3 In CP21/9 and PS21/20, published in July and November 2021 respectively, we consulted on and introduced changes to the rules relating to research. These changes broadened the list of what are considered acceptable MNMBs to include research on SMEs with a market cap below £200m and FICC research, so that these are not subject to the inducement rules. They also made rule changes on how inducement rules apply to openly available research and research provided by IRPs.

Investment Research Review

2.4 The IRR was commissioned by HM Treasury to evaluate the provision of investment research in the UK and its contribution to the international competitiveness of the UK's capital markets. It considered amongst other things the impact of the unbundling rules on payment for investment research on the supply and demand for research services. The IRR's recommendations were published in July 2023. It also builds on the Wholesale Markets Review (WMR), conducted in tandem with the HM Treasury, following the onshoring of UK legislation.

2.5 The IRR concluded that the MiFID II unbundling requirements have had adverse impacts on the provision of investment research in the UK, and that this has a potentially negative impact on economic growth, as increased amounts of investment research could increase UK capital market depth, thereby also increasing the amount of

funding available to UK companies. The IRR also found that the existing unbundling requirements may reduce UK asset managers' access to global investment research, placing them at a competitive disadvantage against their international peers.

2.6 Our option shares many features with the initial proposals of the IRR. Guardrails (listed under 1.19) such as the requirements for a formal policy on how investment research is paid for, a structure for the allocation of payments between research providers (similar to CSAs), an approach for the fair allocation of costs across clients, disclosure of costs to clients, and assessments/benchmarking of the price/value of research are all relatively similar to the recommendations of the IRR. Our option has supplemented these with requirements around budgeting and operational procedures.

Arrangements in other jurisdictions

2.7 In the US, the use of "soft commissions" is commonplace, under which payments to broker-dealers for execution and research services are combined or "bundled". This can include "full bundling", under which research can only be procured from the broker-dealer with which trade execution was undertaken. However, the use of structures such as CSAs is also prevalent; these allow asset managers to pay a broker-dealer for trade execution, yet to have the portion of commission allocated for research available to be used to purchase it from a different broker-dealer or IRP. On the other hand, US broker-dealers must register as investment advisers if they wish to accept payment for research separate from execution commissions. This is because separate payment can be treated as special compensation for the purpose of the Investment Advisers Act of 1940. The Investment Advisers Act of 1940 provides an exclusion from the requirement to register as an Investment Adviser if the investment advice provided by the broker-dealer is purely incidental to the brokerage business and they receive no "special compensation" for providing the advice.

2.8 In 2017, the Securities and Exchange Commission (SEC) issued a no action letter providing relief to US broker-dealers accepting unbundled payments from EU and UK asset managers for research services. The relief expired in July 2023, and although evidence of any negative impacts on UK asset managers is limited, it is important for UK asset managers to be able to obtain research from global sources without impediments to remain globally competitive.

2.9 The EU is introducing legislative adjustments to the MiFID II unbundling rules to offer firms greater flexibility on how to pay for investment research services. This includes a new payment option to bundle research payments with execution, alongside a number of requirements firms using it will have to comply with. Our option shares certain features with these recent EU legislative developments (e.g. transparency on the payment option selected by a firm, maintenance and disclosure to clients of a policy to manage conflicts of interest, regular assessments of the quality and value of research, an approach to separately identify charges for research from total charges for investment services, disclosure to clients of costs, and the exclusion of sales and trading commentary from relevant requirements). At time of publication of this PS, the EU policy-making process had not set out expectations in certain other areas covered

by our option (e.g. budgets for research spending, an approach to the fair allocation of costs across clients, a structure for the allocation of payments across research providers similar to CSAs). At time of publication of this PS, the EU requirements are also less explicit in certain respects (e.g. cost disclosures to clients are only required upon request and if known).

Academic research on unbundling

2.10 A summary of the academic research on bundled payments and how it is incorporated into our analysis can be found in CP24/7.

Prior regulatory studies on unbundling

2.11 A summary of prior regulatory studies undertaken on the impact of the MiFID II unbundling reforms on markets in the EU and UK can be found in CP24/7.

Wholesale Markets Review

2.12 As noted in 2.4, these rule changes build on the WMR, which was established to improve the UK's regulation of secondary markets, taking advantage of new flexibilities in financial services following our withdrawal from the EU. A summary of the objectives of the WMR, and how these related to these rule changes, can be found in CP24/7.

Chapter 3

Summary of responses

3.1 This chapter summarises feedback received and our response, including any changes we are making to our final rules. We have retained the original numbering of the questions in the CP, but have changed the order in which we summarise feedback and our response, to group together those questions where responses raised closely related issues.

Introduction of a new payment option

3.2 In CP24/7, we set out the reasons for potentially introducing a new payment option for investment research. In proposing this option, we concluded that the current option under which UK asset managers can charge investment research costs to clients (RPAs) is operationally complex and resource-intensive to maintain, and that both of the currently available options (RPAs, own resources) can have negative effects on UK asset managers' ability to purchase investment research across multiple jurisdictions without significant and potentially disproportionate operational and regulatory complexities. We asked:

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

3.3 Most respondents supported the policy proposal to introduce additional payment optionality for investment research by introducing changes to the rules in COBS 2.3B. They recognised the potential benefits from additional flexibility on how firms can pay for investment research, including reducing operational complexities, potentially reducing costs for asset managers, and more closely aligning to the regimes in other jurisdictions.

3.4 However, there were different views between respondents on the extent to which the proposals went far enough both in terms of international alignment and offering sufficient flexibility. Some trade associations, brokers[2] and asset managers[3] wanted more complete alignment with other jurisdictions (such as the US) and increased flexibility on how firms implement the accompanying guardrails (especially those on budgeting, cost allocation, and benchmarking), as those were perceived as too complex, onerous and restrictive. Some respondents noted that the new option does not represent "full bundling" due to the requirement to have separately identifiable research charges, which creates misalignment with other jurisdictions that permit full bundling. Another noted that the proposed rules create an uneven playing field at a global level and encouraged us to adopt an outcomes-based approach to rule making.

2 Throughout this section, the term "broker" will be used generically to refer to a range of "sell-side" market participants that would otherwise require more specific and varied terms (e.g. investment bank, broker, broker-dealer, etc).

3 Throughout this section, the term "asset manager" will be used generically to refer to a range of "buy-side" market participants that encompass institutional, retail, alternative and wealth management, and including both individual and collective portfolio management.

3.5 On the other hand, six respondents did not agree with the proposal to introduce additional payment optionality for investment research. The reasons varied from consumer protection concerns to introduction of unnecessary layers of regulation to a regime governed by an already complex patchwork of rules. A respondent opined that the current guardrails do not provide sufficient protection due to the lack of research valuation requirements. The respondent noted that there is a significant risk of financial loss to clients due to their assets being used to purchase duplicative and unnecessary research, suggesting that the new option be used to procure research only in jurisdictions where it is operationally necessary to do so, and that clients be rebated for research expenditure. It also stated that reintroducing fully bundled payments runs the risk of asset managers being less selective about the quality of research that they rely upon. The Financial Services Consumer Panel did not support the introduction of a payment option that allows the rebundling of execution and research payments. The Panel believes that concerns over consumer protection outweigh the harms identified regarding competition and international competitiveness.

3.6 In addition, one firm suggested that IRPs may be disadvantaged by the new payment option, as larger broker-dealers may leverage low-cost research as marketing and to attract trading volumes. The firm also noted that additional payment optionality may do little to encourage the growth of research on SMEs, because higher trading volumes in large cap companies means it will foster research on these companies instead. One firm suggested that the new option, by associating research with trading activity, does not encourage the diversification of research readership beyond actively trading investors. They further asserted that issuer-sponsored research provides a better solution, because investors would be able to direct listed issuers to pay for research from research providers that the investors trust.

Our response:

Having considered the feedback, we are proceeding with the introduction of an additional payment option for investment research. We have taken note of the concerns expressed by some respondents in relation to the new option, and have addressed them in subsequent sections, as listed below.

- The views of those that believe the accompanying guardrails are too complex, onerous and restrictive, and that wanted the introduction of "full bundling", are addressed under Q4 below, including our reconsideration of certain guardrails.
- The views of those that believe the option does not provide sufficient consumer protection are addressed under Q5 below.
- The views of those seeking more complete alignment with other jurisdictions are addressed under Q6 below.

In addition, we would like to make the following observations:

- Regarding the encouragement of outcomes-based rule making, we believe this is already the approach we have taken, and many of the guardrails already specify outcomes and provide latitude on how these are achieved.

- We made clear in our CP that the perceived harms with respect to UK equity listings cannot be attributed directly and solely to rules around research payment options, and that direct benefits (while plausible) have a lesser evidence base. We are nonetheless undertaking broader reforms aimed at encouraging a more diverse range of companies to list and grow on UK markets, and thereby promoting more investment opportunities for investors. These include the WMR (see 2.12) and recently finalised changes to our Listing Rules as part of the Primary Markets Effectiveness Review (PS24/6). We have also published today two consultation papers on rules to implement the new Public Offers and Admissions to Trading Regulations 2024.
- Regarding restricting use of the new option to jurisdictions where it is operationally necessary to do so, and having clients rebated for any costs borne, we do not consider this necessary. This would only be required if we were not satisfied with the robustness of the guardrails around the option as currently framed. It would also largely reverse (or at least significantly complicate) any benefits in terms of increased alignment with relevant international standards (as covered under Q6 below).
- Regarding encouragement of research by IRPs, our option already goes beyond those of other jurisdictions in its requirement that payments be made via a structure that includes such IRPs, whereas other jurisdictions typically facilitate also "full bundling" (where research may only be purchased from the executing broker).
- Regarding encouragement of sponsored research, this is covered by Recommendation 5 of the IRR, and is not in scope of this PS.

3.7 In CP24/7, we sought to understand the likelihood of firms availing themselves of the new option, noting that it would exist alongside the other two options already available and currently used by firms. We asked:

Question 2: ***Would you be likely to take advantage of the proposed new payment option?***

3.8 A high-level summary of responses to this question is best viewed through two different lenses.

3.9 Of the individual asset managers who responded, a reasonably sized cohort indicated that they would use the new option, whilst a larger cohort either had no view or would not. The following is helpful context to these responses.

- Those that indicated they are likely to use the new option typically did so in a straightforward manner, requiring no further interpretation.
- Of those that had no view, some were undecided because they still needed to work through commercial and operational considerations, while others were undecided as they were concerned with specific guardrail features.
- Of those that indicated they would not use the option, in some cases this was because they had a corporate preference to pay for research out of own resources,

while in other cases it reflected concerns about design of the new option. Some noted that they would await an assessment on the administrative complexity around having multiple payment options before proceeding. Others noted the importance of alignment between COBS 2.3 and COBS 18 before implementing the new option (as well as in response to Q8 below). Another firm noted a reluctance to utilise the new option because it would incur additional costs using third-party aggregators to run CSAs, as well as additional internal costs to set up the requirements around the new payment option. Some firms noted that the guardrails are too onerous, overly prescriptive and not aligned with standards in other jurisdictions, and therefore did not represent a superior alternative to existing options.

3.10 Other market participants (e.g. sell-side firms and exchanges) expressed views and a willingness to accommodate the option in approximately the same proportion as above, with some noting that the proposal may lead to increased consumption of research and perceiving this as a positive action.

3.11 Three respondents asked why our CP proposed an option while simultaneously presenting survey results that indicated low potential take-up of it. Two respondents suggested that we more actively encourage firms to take up the new option.

Our response:

Having considered views on likelihood of use, we are proceeding with the introduction of the new option. The proportion of potential take-up among consultation respondents is not dissimilar to the proportion of survey participants that were not content with current payment options in CP24/7. Furthermore, a number of those with no view have noted in their responses that they may take up the new option either after having reviewed commercial considerations or when they review its final form (with modifications made in this PS). Consequently, we believe that there is sufficient demand for use of the option over the short and medium term, while in the longer-term further incremental take-up is likely (but may depend on firm choices or other factors not directly within the FCA's control).

We further consider below the broader context of responses received from asset managers, including how they answered other questions.

- There were firms that agreed with the introduction of an option, were positive about its design, and intended to use the option. This implies some immediate supportive demand for use of the new option.
- There were also firms in favour of a new option, believed it to be appropriately designed, but nonetheless did not want to take it up themselves. This supports our position that this is about choice – firms may be content for the option to be available, even if it does not meet their own preferences.
- Other firms noted that there were factors outside of regulation that might drive the decision to stay on their existing option, such as client engagement and competitive considerations. This implies a cohort of

firms that may choose to remain on other options for reasons unrelated to the precise specification of the new option. The situation with such firms may evolve over time. Some firms are already assessing the new option from a commercial perspective. Other firms considered the new option to be preferable from a long-term perspective, but were considering the near-term switching cost. New entrant firms, of course, will not have to balance considerations of prior investment in another payment method or existing contractual client relationships, and may have a more straightforward decision.

- Finally, there was a cohort of firms that said they would not use it because of the guardrails. In some cases the guardrail features in question have since been modified (see Q4), so their take-up becomes more likely. However, other firms wanted an even more streamlined version of the option, with guardrails sufficiently reduced as to potentially undermine the FCA's consumer protection objective. It may be that other payment methods are better suited to such firms.

Looking beyond asset managers, other respondents (such as brokers, service companies and other market participants) were on balance looking to accommodate asset managers that choose to use the new option.

In terms of other responses to note:

- Regarding the question about why we consulted on an option with low potential take-up, we would like to clarify the sequencing of our prior work. We did not undertake a survey that presented a specific option to firms to opine on. Rather, we undertook a survey that solicited their views on likely take-up of a new option in ***general*** terms, and then presented them with guardrail-specific features of a potential future option to opine on one-by-one ***individually***. The results of this survey were then used to inform the design of the option as presented in CP24/7 that followed. Consequently, the survey did not solicit views on the option set out in the CP; rather, it preceded and informed the design of the option set out in the CP.
- Regarding the suggestion that we more actively encourage firms to take up the new option, it is our view that the new option is complementary to (and not intended to supplant) existing options. (See also client engagement on choice and change of payment option under Q4.)
- Regarding alignment between COBS 2.3 and COBS 18, as covered above (1.9, 1.10, 1.34), the policy intent is to make further changes that ensure consistency across these rules, and we plan to set these out in a future consultation shortly in the autumn.

3.12 In CP24/7, we solicited views on potential success measures, noting that the success of the policy could be measured by take-up of the new option and any marginal increase in research production resulting from these changes, but that we had not at that stage determined in detail the key indicators we would use to monitor whether the new option is achieving the key outcome. We asked:

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

3.13 Many respondents believed that take-up of the new option is the most important success measure. Some respondents suggested not just take-up in absolute terms, but relative to use of other existing payment options. There were also suggestions of measuring UK take-up compared to EU take-up of its new option. Some respondents suggested a survey to measure take-up, while other respondents suggested that there are other ways to measure this (e.g. via increased UK usage of CSA aggregators and similar service providers). Others proposed success measures with respect to reductions in operational complexity and sufficient transparency of charging structures, albeit qualitatively and without specific metrics proposed.

3.14 Other success measures were proposed with respect to research production and consumption. On the production side, these included levels of analyst coverage of UK issuers, the adequacy of research in terms of availability and quality, and the amount of SME research production. On the consumption side, these included changes in total research spending, research purchased by provider type (e.g. independent research), changes in breadth of research providers used by market participants, changes in the range of research purchased, evidence of increased dissemination and use of research (e.g. "click-through" rates), and changes in fee levels paid for research. However, other respondents said that increases in research spending would in itself be too simplistic a success measure. It was suggested that a survey could be undertaken to measure metrics of this type, and that the survey base be widened (e.g. to include IRPs). There were also proposals of success measures of a more qualitative nature, such as assessments of fund managers' reports assessing value for money of research purchased.

3.15 There were also success measures proposed that pertained to UK equity market conditions. These included such metrics as the number of UK-listed companies, the number of UK IPOs, levels of liquidity in UK markets, and capital deployment in UK wholesale markets.

3.16 Finally, there were success measures proposed that related to the UK asset management industry, such as the assets under management in the UK, both in absolute terms and relative to other jurisdictions and investment outperformance.

Our response:

Having considered responses, we believe there should be a three-pronged approach to measuring success.

- First, take-up of the new option, given the aim of introducing an option that is operationally efficient and adaptable to firms of different business models and sizes.
- Second, positive changes in trends of research production/consumption and in the structure of that market, e.g. asset manager satisfaction with the quantity and quality of research available, asset manager satisfaction across different research types (geography, market capitalisation, sector), research spending by provider type (and diversity among these).

- Third, indicators that the above success measures have not been achieved via undue costs or harms to consumers, e.g. research costs borne by investors, including such costs in relative terms (e.g. as a percent of assets under management, relative to trade execution costs).

This could be achieved by undertaking a survey, after a reasonable period of time, and potentially building on the types of data and information that were previously surveyed on to inform our CP. Conducting a survey after a suitable adjustment period also accounts for the different horizons over which firms may take up the option.

Interpretation of these success measures would have to be carefully considered, as the overall balance of impacts across the three dimensions outlined above may be more important than the direction of individual metrics. For instance, increases in total research spending and increases in research price levels may bring competitive benefits to the market for research services, but should not be accompanied by undue costs or harms to consumers bearing such increased costs (e.g. overconsumption of unnecessary research at unwarranted higher prices).

We believe it would be better for the FCA to measure this directly among its population of regulated firms than to seek a proxy (e.g. the use of CSA aggregators by UK firms). Regarding the suggestion of comparing take-up with other jurisdictions (e.g. EU), this may be challenging, as it depends on data availability (the FCA cannot itself collect data from market participants in such jurisdictions), as well as a common approach to measuring take-up, applied at the same point in time.

When it comes to benefits to the UK market for asset management services, investment research specifically and regulation more generally may not necessarily be the key drivers of competitiveness and growth, and a range of other macro-economic and capital markets factors can have significant impacts. Consequently, we do not support assets under management in the UK as a success measure specifically for these changes. Finally, we have not included respondent suggestions on UK equity market conditions among our success measures. This is due to the lesser evidence base of the interrelationship between the introduction of a new payment option and the functioning of UK capital markets (as covered in CP24/7), and because other factors may be more determinative here.

Design of the new payment option

3.17 In CP24/7, we outlined that the changes proposed should advance our competition objective by promoting effective competition for asset management services among asset managers. We anticipated that it would provide a less operationally complex and resource-intensive option to the typically smaller firms that currently use RPAs, and also

be more adaptable to the business models of new entrants and small but fast-growing firms. We asked:

Question 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?***

3.18 There was an even split between respondents who agreed with this and those who did not. Reasons to support the new option included removing barriers to entry for new firms by shifting the cost of research budgets away from asset managers' balance sheets, especially as research budgets can be significant relative to the manager revenues, as well as the lesser operational complexity associated with implementation. One trade association noted that the new option is likely to boost competition and increase choice across the market.

3.19 The Small Business Practitioners Panel (SBPP) indicated that it supports the intention behind the proposal but does not consider it to have high prospects of success. The SBPP is sceptical about firm take-up of the new option due to operational complexities. The SBPP noted that the new option potentially has higher administrative costs, as trade execution would have to be unbundled from research for disclosure purposes. The SBPP said that the Consumer Duty regime provides a sufficiently robust framework to underpin an approach, as opposed to the bespoke guardrails of this options, and proposed that firms should be given greater freedoms on how they manage investment research procurement.

3.20 Of the respondents who do not view the new option as operationally more efficient, many expressed a concern that the guardrails attached to the option are too onerous. A large subset of those requested greater operational latitude to the guardrails that pertain to budget setting, cost allocation and disclosure, price benchmarking and disclosure of the most significant research providers (see below for more details on each). There was also a small number of respondents requesting other specific changes, including lesser points of drafting.

- **Budgeting:** The predominant view amongst respondents was that firms should be allowed to set budgets in a manner that is most appropriate to them and their clients, and that the language of the guardrail should be amended to reflect such additional flexibility, enabling asset managers to set it at an appropriately aggregated level.
- **Cost allocation:** The predominant view mirrored that of budgeting, i.e. it should enable firms to undertake this at an appropriately aggregated level. A number of respondents also noted that portfolio managers often oversee different strategies and portfolios, and therefore it would be challenging to allocate research to a specific strategy or portfolio.
- **Cost disclosures:** One trade association stated that firms should be able to determine whether it is appropriate to make disclosures around research expenditure. Other respondents asserted that disclosures need to be provided at the firm level and should only be made periodically or in response to specific client queries; that a sufficiently rigorous guardrail on budgeting obviates the need

for a guardrail on cost disclosures; and that the guardrails on budgeting and fair allocation of costs can be combined. One respondent suggested disclosing cost as a percentage of assets under management or relative to trading costs. One respondent referred to the guardrail for cost disclosure and proposed for it to be included in the proposals of the new UK disclosure regime following the revocation of the Packaged Retail and Insurance-Based Investment Products (PRIIPs). One respondent noted that it would be challenging to estimate research costs for the purposes of ex-ante reporting as set out in the proposed rules, and of limited benefit to clients who are engaged in on-going discussions on their research payments.

- **Price benchmarking:** A number of respondents indicated that price benchmarking in the form specified in the CP might be challenging for firms to undertake without the risk of oversimplification or inaccurate comparisons, and that internal capabilities might not always suffice to undertake it in the exact form specified. One trade association noted that the guardrail is problematic due to the underlying assumption that investment research is a commodity rather than a service whose value depends on the firm's internal assessment, taking into account the investment strategy and the decision making of the portfolio manager.
- **Research provider disclosures:** Many respondents opined that the proposed requirement to disclose the most significant research providers is too administratively onerous, whilst benefits from information from such providers would not serve any beneficial purpose to the recipients of this type of disclosure. The list of most significant research providers may change on a regular basis and be similar from firm to firm, meaning that any such list would only be a snapshot to clients unlikely to provide any meaningful information. For other asset managers disclosing the list of most significant research providers would constitute commercially sensitive information.

3.21 Some respondents raised a concern that we are not introducing "full bundling". This means that we are requiring CSA-like arrangements, whereby the research charge is an identifiable component of total charges for trade execution and research, and it is possible to purchase research from a range of providers. (To clarify, "full bundling" does not necessitate calculating what portion of total commission is a charge for research, and research is acquired only from the firm through which trade execution occurred.) Such respondents highlighted that the new option is more restrictive than the EU's expressed intention, where their legal text references bundled payments more generally, and thereby provides firms with greater flexibility to operate in either a fully bundled form or with a CSA-like mechanism. Five firms felt that our choice of terminology made it ambiguous whether our requirement for a research provider payment allocation structure accommodated full bundling or restricted firms to CSA-like arrangements – though most of these firms intuitively understood it to be the latter. Two firms were concerned with the risk that sell-side firms would insist on bundled payments, and no longer accommodate other payment methods.

3.22 A minority of respondents proposed additional guardrails. Two respondents suggested that there be mandatory disclosure of the proportion of research spending that is on research from IRPs, with one acknowledging that if this were not applied to other existing payment options also, it might frustrate take-up of this new option. One respondent proposed disclosure on research costs as a proportion of assets under management,

and disclosure on the costs of trading versus the costs of research. One respondent suggested cost disclosures whenever and wherever the investment management fee is shown. Two respondents suggested a greater degree of advance client engagement should firms choose to switch to the new option, with one proposing that firms give clients at least six months' notice before switching, and the other proposing that it be regarded as a significant change for consumers, necessitating that all consumers that have invested since MiFID II be asked for consent and given the option to disinvest without penalty.

3.23 Two respondents suggested there be further specificity on operational procedures for the accounts (COBS 2.3B25(R)(4)), one seeking a more precise definition of "timely payment", and the other seeking a greater level of detail more generally across operating procedures – while simultaneously acknowledging that this greater level of prescriptiveness would potentially hinder take-up of the new option. However, another respondent cautioned against including too much prescriptiveness in operating procedures, opining also that timeliness and terms of payment should be determined by the parties themselves, and not specified in regulation.

3.24 One respondent asserted that the guardrails should not require an individual agreement with each research provider setting out a methodology on how to separately identify research costs, but should instead just require that there be a process in place to isolate the cost of research within overall commissions. Another respondent asserted that it is impossible to have a "separate price" for research, as its value differs according to a client-specific usage range, and any requirement to price it will create frictions and hinder take-up. It was asserted that there is no agreement in the market ecosystem on how to value or price research due to a number of challenges, such as whether investment research is a product or a service, the fact that it often serves multiple purposes, and also the value of the research varies depending on the investment strategy and time decay (i.e. a piece of research may have a very short life span but still be highly useful).

3.25 Four respondents believed that even though our introduction of the new option was intended to support small firms from the perspective of our competition objective, it may be challenging for firms of such size to implement it in its current form, with some of these respondents suggesting it may be only larger firms that will have the operating scale to implement this option efficiently, and consequently encouraging simplification of certain guardrails.

3.26 Finally, there were respondents that asserted that the combined guardrails are too onerous, while simultaneously suggesting the addition of further guardrails to fulfil specific industry perspectives they believed to be of particular value.

Our response:

Having considered this feedback, we are making some changes to our final rules. The most significant are with respect to the guardrails on budgets, research provider disclosures, price benchmarking, and cost allocation and disclosures. We are making a more minor modification to the guardrail on separately identifiable research charges.

By way of background, the responses to Q4, Q5, Q6 and Q8 often raised similar points with respect to the design of the option proposed, but from different perspectives – from the perspective of ease of implementation (Q4), international alignment (Q5), consumer protection (Q6), and ultimate likelihood of take-up (Q8, but also covered under Q2 above). To avoid repetition, we will consequently lay out here:

- our response to views received on guardrail features, and how we have taken these into account when finalising the new option;
- what this means from the specific perspective of efficiency and adaptability of implementation by firms.

In our response to subsequent questions, we will consider it from the other perspectives enumerated above, but without repeating the analysis here.

We take first the points raised on budgeting, research provider disclosures, price benchmarking, and cost allocation and disclosure.

- **Budgeting:** We have amended this guardrail in response to feedback. When outlining how budgeting should be undertaken in COBS 2.3B.25(R)(5)(B), we had previously provided examples that it could be done at the level of an investment strategy or group of clients. We have now changed this to accommodate a level of aggregation that is appropriate to a firm's investment process, products, services, and clients. However, it is also stipulated that this should not compromise a firm's ability to meet the separate guardrails on fair allocation of costs and client disclosures. We believe that this should provide sufficient flexibility to accommodate firms with different group structures, procurement processes (centralised or distributed), investment strategy taxonomies, approaches to organisation of analytical resources and investment decision-making (centralised, by strategy, by desk), and homogeneity or heterogeneity of client base. In COBS 2.3B.31(R)(3) we have also made a small change, clarifying that disclosures on budgets exceedances can be part of a firm's next periodic report on costs and charges, rather than as a separate communication to clients to be made within that research budget period.
- For avoidance of doubt, the requirement that budgets be set at least annually does not preclude more frequent consideration of budgets, whether regularly or when circumstances necessitate a mid-period adjustment. Furthermore, where client disclosures are set out in other requirements, it does not specify there that overall budget amounts need to be disclosed – we recognise this may be commercially sensitive information.
- **Research provider disclosures:** We have amended this guardrail in two ways. First, it no longer requires the disclosure of the most significant research providers in COBS 2.3B.30(R)(4). It has replaced this with a requirement to disclose instead the types of providers from which research services are purchased. This is accompanied by guidance in COBS 2.3B.32(G) clarifying that a breakdown according to IRPs vs non-IRPs is one way of meeting this requirement. Second, we have amended

the level of aggregation at which such disclosures in COBS 2.3B.30(R)(4) are to be made, to mirror those of the budgeting guardrail above (i.e. at a level of aggregation that is appropriate to a firm's investment process, products, services, and clients). These changes address concerns about providing information that may be either uninformative or commercially sensitive, while still requiring disclosure on the principal services and the broad categories of providers on which clients' monies are spent. The changes also address a number of responses proposing increased disclosure on the proportion of research procured from IRPs, while providing sufficient latitude by embedding this in guidance. A payment method that explicitly combines trade execution with research makes transparency on this provider distinction more important than other payment options.

- For avoidance of doubt, the requirements of COBS 2.3B.30(R)(4) and 2.3B.32(G) do not necessitate disclosure of the actual amounts paid; these are just used to determine significance.
- **Price benchmarking:** We have amended this guardrail in response to feedback. Previously there was a requirement to undertake benchmarking of prices paid for research services against relevant comparators to ensure charges to clients are reasonable. We have amended this to require that firms ensure that research charges to clients are reasonable, whilst guidance clarifies that benchmarking of prices paid for research services is one means of demonstrating compliance. We believe this is a proportionate approach to focusing on the outcome we are seeking to achieve, indicating an approach that can enable firms to meet the requirements, while providing latitude for other approaches that may also be appropriate.
- **Cost allocation and disclosure**: We have amended the relevant guardrails in response to feedback. First, in the guardrail on fair allocation of costs (COBS 2.3B.27), we have kept such aspects as considering clients with different payment arrangements, clients that are managed according to similar investment strategies, and clients or groups of clients that benefit from the same research. However, we have also provided latitude to implement alternative levels by which costs are allocated, provided these are appropriate to a firm's investment process, products, services, and clients. This provides similar latitude as the modified budgeting and research provider disclosure guardrails. Second, we have amended the guardrail on providing expected annual costs to clients, as part of ex ante disclosures on costs and charges (COBS 2.3B30(R)(3)). Previously these had to be based on ***both*** the budget-setting and cost allocation procedures ***and*** the actual costs for prior annual periods. They now only have to be based on the most appropriate of these. This facilitates asset managers calculating one method only where this is appropriate (e.g. where there is a track record of stable research charges that are unlikely to change), but selecting another method when this is more appropriate (e.g. a new product for which a research budget has been set for the first time, an existing product where the level of research expenditure is expected to change).

We believe these are proportionate modifications to address concerns raised.

- In terms of sufficiency of transparency, we do not agree with respondents that: cost disclosures do not need to be provided; cost disclosures only need to be provided at the firm level; the guardrail on cost disclosures can be combined with others.
- Regarding PRIIPs, the new rules will apply only to providers of investment services rather than packaged investment products. For these purposes we have specified that cost disclosure requirements are to be met as part of firms' existing costs and charges disclosures (COBS 2.3B31(R)(2)). Where the cost disclosure requirements to use this new option go beyond those of other regulations firms are subject to (for instance, COBS 16A.4.1UK), they should seek to provide this additional disclosure, while not contradicting the provisions of such other regulations. We plan to replace the PRIIPs regime with a new disclosure regime better tailored to the UK market. When we propose changes to the inducement rules relating to providers of packaged products, including funds, we will consider how disclosures should be made in the context of the relevant requirements.

After an appropriate period, the FCA could choose to monitor emerging practice in the above areas via multi-firm work.

We have also made the following less significant modifications to guardrails.

- **Separately identifiable research charges:** We have modified the requirement that there be written agreements with research and execution providers to establish a methodology for how research costs are identified separately within total charges for joint payments (COBS 2.3(B)25(2)). Instead firms will be required to establish arrangements that stipulate the methodology for how such research costs are separately identified. This addresses the response summarised previously, and also accommodates a broader range of potential market practices and arrangements, both bilateral with firms and multilateral with service providers, both physically and electronically documented, and which could range from negotiated agreements to standard terms of business. On the other hand, we do not agree with the response that it is not possible to have a separate price for research. We understand that both a value and a cost are already assigned to research by providers and consumers, both when paid for separately and when purchased under CSA-like arrangements.

We have not made changes in response to the following feedback.

- **Full bundling vs CSA-like arrangements:** We have chosen not to implement full bundling of the type suggested by some respondents under 3.21. As context, we set out the features of the new joint payment option by describing its requirements, rather than by using existing industry structures or nomenclature (such as "CSAs"). This is because the operating modalities around these can evolve over time, while the

requirements around joint payments do not. For avoidance of doubt, however, with the requirements for separately identifiable pricing for research and for a research provider payment allocation structure that is expected to accommodate different research providers and different types of research provider, we are introducing an option that necessitates "CSA-like" arrangements and that does not facilitate "full bundling". This is by intent. Full bundling would lead to opacity of prices paid for research services, challenge the ability to compare prices paid across research providers, and not preserve competition in the separate markets for research and trade execution. We believe that MiFID II introduced a level of discipline and transparency which exceeds that of fully bundled arrangements, and we want to retain the benefits that have been achieved. Furthermore, although CSA-like arrangements may not be a regulatory requirement in other jurisdictions, they are a common operating practice and a frequent firm choice in research procurement. Finally, from our earliest engagements and submissions, many asset managers expressed reluctance to reintroduce the price opacity and lesser choice that could arise from full bundling.

- The above requirement for CSA-like arrangements instead of full bundling should also address the concerns some respondents raised on brokers insisting on joint payments. This is because with a CSA the broker cannot be certain that the research component within total commission paid will be used to procure research from that same broker, instead of from other providers. However, the IRR recommendation that sell-side firms should not be required to facilitate payments on a bundled basis, or be able to require that buy-side firms use bundled charges, has not been explicitly included in requirements. To do so would risk providing a new payment option to market participants while simultaneously neutralising the choice of those that wish to adopt it. It could also create an unlevel playing field if the requirement can only be applied to UK providers and consumers of research, and not to the providers and consumers in other jurisdictions (due to considerations of extra-territoriality). The choice between the three options under which to pay is consequently better handled as a commercial matter between the buyers and sellers of research.
- **Operational procedures:** We believe that the benefits of providing further detail on operating procedures under COBS 2.3B25(R)(4) would be outweighed by the reduction in latitude in how firms implement the new option, which could ultimately hinder its take-up. In reaching this view, we are taking into account the operational complexities that certain firms have highlighted to us with respect to the more prescriptive requirements around RPAs. For example, we have chosen not to give additional specificity to the provision on ensuring timely payments to research providers. To do so would make the requirements more prescriptive than those for RPAs (under COBS 2.3B.18), potentially hindering take-up of the new option. It would thereby inadvertently work against those respondents that both wanted us to encourage take-up of the option and also wanted us to prescribe more tightly defined

payment windows. These opposing dynamics were in some cases recognised by the respondents themselves. Finally, to provide a short and fixed payment period may not accommodate varying operating practices, e.g. if payment periods are in some cases aligned with a longer horizon over which the success of investment outcomes achieved by third party research can be measured.

- **Client engagement on switching:** Our rules set out which research payment options are permissible. But firms also have contractual agreements, such as investment management agreements, with their clients. This change to regulation does not override any such existing agreements with clients. Consequently, firms would need to determine what contractual obligations they are under before starting to use this payment option, including what information they would need to communicate to clients, and whether they would have to obtain client consent. Where there is a retail client, firms would also need to consider the Consumer Duty (as covered in CP24/7 (2.33)).

3.27 In CP24/7, we outlined that one of our operational objectives is to secure an appropriate degree of protection for consumers. We anticipated that the changes proposed would advance our competition objective (see 1.13 above), but without undue costs or harms to consumers, due to the proposed guardrails around firms' use of the proposed option. We asked:

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

3.28 The majority of respondents agreed with this, although there was a sizeable minority that offered no view. Of those that did not agree, they were split between those that believed the guardrails overemphasised consumer protection and those that conversely wanted a higher degree of consumer protection.

3.29 Of the respondents that agreed, some provided additional suggestions for consideration. For instance, one respondent noted that any value-for-money assessments should include also the cost of internally generated research, and that Consumer Duty value-for-money assessments should include the cost of research. Another respondent noted that it would be beneficial to include disclosure on research with ordinary cost disclosures. One trade association suggested including further mandatory disclosures across all payment options (not just this one) regarding research costs, and distinguishing whether they relate to research services that are independent and conflicted/unconflicted.

3.30 Of those that did not agree, some believed the requirements to be overly onerous, while others considered that they did not secure a sufficient degree of consumer protection. For instance, one trade association noted that the rules are disproportionate in comparison to the standards in other global markets, and consequently the focus on consumer protection fails to take into account the overall impact on the competitiveness of UK capital markets, which could lead to users of investment research

in the UK being placed at a disadvantage compared with those in other financial centres. Conversely, our Financial Services Consumer Panel raised concerns that consumers may not be aware of the costs incurred and whether these represent value for money; that consumers may lose the ability to compare costs and make informed choices; and that firms may lose discipline on research spending. It also opined that the narrative about increasing competition should not trump our consumer protection objective, and reiterated that international competitiveness and growth is a secondary objective. Finally, one respondent proposed further disclosure guardrails that would include information on the costs of execution and research as part of standard reporting (on request), as well as disclosure of the historical or anticipated future costs from research commission payments, and that these should be prominently disclosed when the asset manager's headline fee is published.

Our response:

Having considered the feedback, we believe that we have appropriately balanced our objectives in reaching a final version of the new option.

We believe that the guardrails maintained around firms' use of the option should advance our competition objective without undue costs or harms to consumers. Overall, we believe that the features of the new option should ensure sufficient levels of discipline, transparency and fair treatment across clients with respect to the costs and benefits of research expenditure, and thereby secure an appropriate degree of consumer protection. On the other hand, we have sought a proportionate and flexible approach to achieving these outcomes. This includes the changes we have made to the guardrails we initially proposed in CP24/7, which do not change the consumer outcomes they seek to deliver, but offer more flexibility to firms in how to achieve those outcomes. Without such guardrails we could not address potential concerns on less disciplined spending on duplicative or low-quality research, inappropriate influence of research procurement on trade allocation decisions, and opaque charging structures.

On the suggestions we received for additional guardrails, we do not think these could be incorporated without increasing the burden and complexity for firms implementing the new option (e.g. detailed information on the relative costs of trading and research) or disclosing information that could be commercially sensitive or lead to misrepresentative comparisons (e.g. the cost of internally produced research).

Regarding the suggestion that the guardrail on assessing the value and quality of research (COBS 2.3.B25.7(a)) be more closely linked to value for money assessments as part of the Consumer Duty. As stated in CP24/7 (2.33), where the obligations of the Consumer Duty apply in relation to a firm's business, products or services, the firm should ensure its policies and operational arrangements for joint payments provide an appropriate level of protection for retail customers, in accordance with the requirements of PRIN 12 and PRIN 2A. However, it is not our intention to

limit the approach or confine the scope of application of such provisions on joint payments to relevant provisions in the Consumer Duty.

3.31 In CP24/7, we outlined that when advancing our primary objectives of consumer protection, market integrity and effective competition in the interest of consumers, we have a secondary objective to facilitate the international competitiveness of the UK economy, and its medium to long-term growth, subject to aligning with relevant international standards. We noted that when considering the design of the new option we had regard to the features of payment structures in operation in other jurisdictions. We anticipated that the new option should facilitate UK asset managers accessing research globally, and thereby being better able to compete on an international scale. We asked:

Question 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?***

3.32 Most of the respondents that answered this question agreed that the new payment option would facilitate operational efficiencies via increased international alignment, whilst the remainder either disagreed or had no view.

3.33 Of those that agreed, one firm noted that the new payment option provides continuity and consistency, as guardrails such as budgets and valuations are already in place with managers operating RPAs. It was also opined that the new option facilitates a more level playing field in a bundled global market. One trade association noted that there is a significant potential benefit with increased payment optionality in allowing greater alignment with research payment requirements in other jurisdictions, particularly the US and EU. A subset of these respondents viewed the new payment option as moving in the direction of research procurement practices in other jurisdictions, but noted that the guardrails are not fully aligned with the requirements of other jurisdictions and are more prescriptive. One trade association noted that it is necessary that any additional transparency in guardrails – such as whether costs related to research services are independent and unconflicted – be applied across all payment options (not just this one), to ensure that the new payment option is not disadvantaged relative to them.

3.34 Of those that did not agree, many believed the guardrails to be too prescriptive, onerous and divergent from practices in other jurisdictions. In many cases the specific guardrails such respondents highlighted are those covered under Q4 (i.e. those to which we have since made modifications). One trade association noted that the new payment option is a CSA model combined with RPA features, resulting in a hybrid that does not deliver on operational efficiency. Some respondents, including one trade association, noted that the new payment option should be mapped to the requirements of other jurisdictions, e.g. UK asset managers should be able to use US-style CSAs. One respondent noted that take-up is likely to be impacted by firms having to invest in additional controls to ensure that clients can be serviced under a UK-style CSA. One trade association was of the view that the assessment of whether the allocation of costs is "commensurate" with the benefits received is too granular, and that the assessment should be carried

out at the adviser (i.e. firm) level, as opposed to the level of a subset of clients in similar investment strategies or similar groups of clients, and that this would be more closely aligned with the US framework. It further noted that research services benefit multiple clients simultaneously and to differing degrees, which in turn makes quantifying the benefits at the granular levels challenging.

Our response:

Having considered the feedback, we have made several adjustments to the guardrails, as described under Q4, which we believe will alleviate concerns with respect to international alignment.

None of the responses received indicated that it would be impossible from a legal and compliance perspective simultaneously to meet our requirements and those of other jurisdictions. This means that the types of direct conflicts of regulatory requirements that arose between EU/UK and US practices after the introduction of MiFID II (and covered in 2.7 to 2.8 of our CP) are not relevant here. Instead, the issues at hand are:

- regional variations in requirements, and the ability to simultaneously meet these without undue burden;
- adjustments to existing operating practices to meet new requirements, where such operating practices have largely developed over time in other jurisdictions.

As outlined under Q4, we have made modifications to a number of guardrails compared to the initial proposals of our CP. While these adjustments were largely informed by our reconsideration of how they might best meet their stated intent without undue burden, our modifications should also facilitate increased compatibility with operating practices in other jurisdictions compared to our initial proposal. As covered under 2.9, our option continues to have many features in common with the outcome of recent EU legislative developments. It also shares a number of features with common operating standards for research procurement in other jurisdictions, such as the US. There were suggestions that we should not consider including certain guardrails because they do not exist in other jurisdictions, and that we should replicate and not deviate from the requirements of such jurisdictions. We have instead sought to ensure that the new option advances our primary objectives (including securing an appropriate degree of protection for consumers), while optimising the extent to which it is compatible with those of other jurisdictions and avoiding any direct conflicts with these (thereby advancing our secondary objective on international competitiveness and growth). However, we will keep international developments under review in future years, given a key intent of our changes is to ensure the interoperability of this new option with payment models in other jurisdictions.

3.35 In CP24/7, we proposed that a firm must meet the requirements in relation to the operation of the new option, and we set these out as draft amendments to COBS in Appendix 1 of the CP. We asked.

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

3.36 Unlike prior guardrail-related questions (Q4, Q5, Q6), this question did not seek agreement or disagreement on a stated premise but provided respondents an opportunity to raise any positive or negative points for our consideration. A large proportion of respondents took the opportunity to volunteer suggestions on features of the option for us to consider.

3.37 A number of respondents noted that the prospect of the new payment option being taken up by firms would improve if COBS 18 is changed alongside COBS 2.3, to ensure that one process can be applied to clients across a range of portfolio types.

3.38 Otherwise, many of the points raised replicate very closely those already covered above (Q4, Q5 and Q6). Such responses noted that take-up is likely to improve if the guardrails on budgets, cost allocation/disclosure, price benchmarking, and the disclosure of significant research providers are not overly prescriptive and set at an appropriately aggregated level (not necessarily the investment strategy level). It was indicated that this would particularly ease take-up among smaller asset managers or new entrants, as well as firms for which international alignment would be a priority.

Our response:

Much of the feedback to these responses has already been covered under Q4, Q5 and Q6, including modifications we have made to the final option.

Our approach to alignment with COBS 18 is covered under 1.9, 1.10 and 1.34 above.

Other related changes

3.39 In CP24/7, we noted that in the US, certain types of short-term trading commentary may be provided by a broker-dealer (which may not be able to receive unbundled payments) rather than by an investment advisor (which will be able to receive them). We anticipated that this could create unintended differences in access to research, to the detriment of existing payment options (RPAs, own resources). For this reason, our proposed changes included adding to the list of acceptable MNMBs for all payment options in COBS 2.3A.19R(5) short-term trading commentary and advice linked to trade execution. We asked:

Question 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)?***

3.40 We received strong support for the proposal, whilst most of the remaining respondents did not express a view on the issue. Of those who supported the proposals, one trade association noted that the proposal will promote international alignment and facilitate dialogue between asset managers and brokers. Three asset managers supported the proposal opining that trading commentary is not on an equal footing with substantive investment research, as the former only looks to a short time horizon, and the proposal would aid the trading process overall as well as removing the administrative and operational burden.

3.41 One of the firms that did not support the proposal noted that the addition of trading commentary as an acceptable MNMB would have the unintended consequence of being used as a soft marketing tool rather than generate any meaningful trading commentary, whilst another firm noted that it would create a competitive disadvantage between IRPs and brokers.

Our response:

Having considered the feedback, we have decided to include the changes proposed in CP24/7 in our final rules. We do not believe that this change is likely to have a sufficiently material impact on competition in the market for investment research to outweigh the market integrity benefits of increased information availability to asset managers.

3.42 In CP24/7, we noted that the option for bundled payments to purchase research on companies with a market capitalisation below £200 million introduced through PS 21/20 has had little take-up, and that the new option for joint payments can apply to research on companies of any size. Consequently, to avoid additional complexity, we proposed that the specific rule relating to SME research in COBS 2.3A.19R(5)(g) be deleted. We asked:

Question 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)?***

3.43 The majority of responses supported the proposal, whilst most of the remainder did not express a view on the issue. Four trade associations noted that the exemption was not appropriately calibrated, the threshold having been set too low, and that the option should have been crafted with a broader remit – covering issuers irrespective of their market capitalisation. They noted the tendency for investment research to combine many different aspects of the market, so creating arbitrary divisions by way of thresholds such as this can be unhelpful, creating additional complexity and cost for those accessing research. Low take-up of the option was presented as a common reason to support the removal of the exemption. One respondent provided survey data

from listed companies indicating that a significant proportion of them (43%) believed that the threshold had been set too low, and that its impact had been negligible.

3.44 One trade association disagreed with the removal of the exemption. It noted that some of its members had availed themselves of it, and that if the exemption was deleted from the list of acceptable MNMBs, it would force those firms to revert back to an unbundled payment model for research on SMEs.

Our response:

Having considered the feedback, we have decided to include the changes proposed in CP24/7 in our final rules. We believe that the three payment options that are now available form a sufficient basis on which to pay for research for such issuers.

Analysis of potential harms

3.45 In CP24/7, we set out background information on how research is paid for and provided analysis of the various considerations that could inform the development of a new payment option. These included considerations of market functioning, capital access and costs, investment performance, investor costs, competition, and competitiveness and growth. We asked:

Question 7: ***Do you agree with the findings set out in the Analysis section of this consultation paper? Please give your reasons.***

3.46 The most frequent position of respondents was that they had no view on the detailed analysis underpinning our proposals. Some did not agree with all its findings. However, most did so without providing any evidence or data to adjust our analysis. Those that did provide new evidence almost exclusively did so in a way that sought to strengthen the case for introducing a new payment option, providing new sources of information and data to underpin the necessity of proceeding with its introduction. The remainder agreed with the analysis as a whole. We take each of these response types in turn.

3.47 Of those that had no view, one emphasised that it did not agree that investment research for asset managers is a "public good". Rather, it believed it is a well-informed marketplace of consumers that know what they need and do not need assistance in procuring it. The same respondent asserted that in our analysis not enough credit is given to the growth of in-house capabilities by asset managers.

3.48 Of those that did not agree with the analysis, some believed that harms of the type examined in CP24/7 are more prevalent than acknowledged. Many of these asserted that the impact of MiFID II on the levels of coverage, quality, quantity, and analyst experience/tenure in investment research is understated, as well as its detriment to UK capital markets. Most respondents made such assertions without the provision of

further information or data to evidence such harms, or to evidence their causal link to MiFID II. However, there were a number of exceptions to this.

- Two respondents provided data demonstrating a fall in UK small and mid-cap research coverage (FTSE 250, AIM).
- One respondent demonstrated that the average number of analysts covering European companies had declined more rapidly than US companies since the introduction of MiFID II.
- Another respondent provided data demonstrating a significant reduction in the number and variety of research sources used by UK asset managers since the introduction of MiFID II, which showed a clear inflection point around the time of MiFID II.
- Another respondent provided survey data showing reduced satisfaction among UK companies with their levels of coverage by research analysts.
- A respondent directed us to survey results[4] that demonstrate a range of 40-80% of fund managers considered that with respect to UK small and mid-cap companies, MiFID II had or will have a quite-to-very negative impact on the availability of research, the variety of research providers, analyst coverage levels, and liquidity. Sentiment in some cases also deteriorated over the 2018-22 period. Only a small proportion of responses (5-15%) typically indicated that MiFID II had a quite-or-very positive impact; the remainder having no view. Responses did not typically express the same level of concern on research quality, in some cases indicating an improvement over time. Sentiment among UK listed companies on the impacts of MiFID II was also negative, albeit more balanced overall.
- Finally, another respondent provided survey results on largely UK (but also European) listed companies, which showed a small majority that were either very or somewhat satisfied with the quality of analyst research on them (53%) and the number of sell-side equity analysts covering them (55%).

3.49 Other respondents focused on the structure of the market for research, but often without supporting data/information. One noted that the issue of "price" and "value" is extremely complex when it comes to investment research. Another noted that MiFID II had increased the downward pressure on research fees, and that the move to P&L made the research payments from asset managers even less transparent, pushing the research market even further from a fair, competitive level playing field. In a similar vein, a respondent expressed surprise that the independent research industry has been portrayed as a winner following the implementation of MiFID II; another that IRPs have seen their businesses almost halve since MiFID II; two respondents alleged that this is due to predatory and below-cost pricing from large investment banks; another asserted that the "share of wallet" captured by IRPs in the CP is misleading, and research from brokers and IRPs should be analysed separately. There were a number of responses indicating that we may be providing "mixed messages" on whether we are supportive of increases in research spending.

3.50 Others that disagreed presented diametrically opposing views. One respondent noted that both the data on the actions of firms post-MiIFID II and their responses to our survey fail to paint a compelling need for change. Another respondent noted there

4 These survey results over the period 2018-22 vary year-on-year, and so must be simplified to summarise.

are other developments that might have impacted supply and demand for third-party research beyond those we listed among the non-MiFID factors in 3.18 of our CP; these include greater use of quantitative investment strategies and increased application of technology.

3.51 Finally, those that agreed with the findings emphasised such points as:

- the disproportionate impact of MiFID II on small asset managers seeking to purchase research on smaller issuers from smaller brokers (especially where such asset managers are not a priority for larger brokers);
- the need to increase the alignment of UK research payment options with those available in other jurisdictions;
- the extent to which MiFID II has had unintended consequences on research pricing and competition in the market for research services.

Our response:

The Analysis section of our consultation paper sought to ensure our policy proposals are underpinned by an analytical, evidence-based and data-driven approach, to complement qualitative and anecdotal information.

There was a higher propensity among asset managers to agree with our analysis, i.e. among those that consume research (as opposed to selling it or providing related services), and consequently also among those that would ultimately choose to use the new option or not. Those that did not agree with our analysis typically either had views on the impacts on UK equity markets or the impacts on the investment research market. These are addressed separately below.

Regarding those that did not agree with the impacts of research unbundling on UK equity markets, a number did not agree with specific aspects of our analysis, but were still in support of the introduction of a new payment option. In other words, it was only on the level of current harms that their views differed. These respondents did not generally provide evidence or data to support their assertions on a greater level of perceived harm, albeit with the important exceptions noted above. For those that did provide further information, notwithstanding the differing scope and approach that may underpin their data or surveys, it serves to bolster the evidence base of the potential market integrity benefits of our change (especially with respect to SME investors and listed companies), given that our CP originally concluded that the benefits to market integrity (although likely to be neutral or marginally positive) had a lesser evidence base.

Regarding those that did not agree with the impacts of research unbundling on the investment research market, they generally too were still in support of a new payment option. In many cases, it was not the trends we identified where their views differed (e.g. decreased research spending, lower research prices), nor the outcomes of such trends (e.g.

a challenging competitive environment for investment research). Rather, many respondents' positions were predicated on an assumption that we should encourage increased spending on research and target higher price levels. In making these changes, we are reducing frictions to research procurement, which might encourage broader consumption. However, it will ultimately be market forces and commercial considerations that determine research spending trends and prices, but we remain open to evidence of whether competition in the market for investment research is working in the interests of consumers.

Finally, regarding responses that believed the evidence in our CP did not demonstrate a compelling need for change, we have mostly addressed these under Q4 and Q5 above. The analysis in our CP made clear that there may be straightforward, albeit long-term, benefits to be gained in enabling greater operational efficiencies in research procurement for firms.

Other considerations

3.52 In CP24/7, having undertaken the analysis outlined above, we asked:

Question 11: ***Are there any further comments you wish us to consider while finalising these proposals?***

3.53 A sizeable portion of the respondents noted that the inducement rules around corporate access should be reviewed and consequently corporate access should be incorporated into the items that can be paid for with the new payment option or when utilising an RPA, as it would result in closer global alignment and enable smaller asset managers to get more corporate access. Failing to allow the same level of optionality for corporate access as there is for research could result in firms being required to run separate payment constructs leading to additional operational complexity. In addition to commentary about corporate access, a respondent asked for clarification on the types of services that can be covered by the new option, noting that the investment process involves a wide range of sources including expert networks and consultants.

3.54 Many firms sought further clarification on the rules pertaining to FICC instruments and how they operate with regards to the new payment option for investment research. Some respondents stated that macro research should be included on the list of acceptable MNMBs, due to its widespread use associated with FICC instruments.

3.55 One firm noted that the inducement rules around access to new research providers should be addressed. The acceptable MNMBs are viewed as restrictive, particularly the three-month trial window.

3.56 Two trade associations noted that they were supportive of a code of conduct for sponsored research (as recommended by the IRR), with one of them indicating that it

would be prepared to support creation of the code, as this would likely alleviate some of the uncertainties around sponsored research and increase levels of confidence.

3.57 One respondent noted that retail investors should have greater access to investor research.

3.58 Three respondents asked for a view on the treatment of a bundled research payment for VAT purposes.

3.59 One respondent queried whether the cost of administering a CSA platform could also be passed on to investors, as is common practice in certain other jurisdictions.

Our response:

The points raised under 3.53-3.55 above all pertain to the broader regulatory requirements on inducements, investment research, the scope of research services, and what may be considered acceptable MNMBs. These are all out of scope of this consultation. We would also note that across a range of questions we had suggestions of changes that could be made to existing payment options (RPAs, P&L), in some cases to reduce the relevant requirements (RPAs), in other cases to introduce increased requirements (P&L). These too are out of scope for this consultation.

The points raised under 3.56-3.57 above all pertain to other recommendations of the IRR. These are all out of scope of this consultation, though we may consider some of those recommendations in the future.

Regarding the request for clarity on the Value Added Tax (VAT) treatment of joint payments, we do not take a view on the tax treatment of goods and services.

Regarding whether the cost of administering a CSA platform could also be passed on to investors, the proposed amendments under COBS 2.3B.23(12) in our CP clarified that this is not intended to be the case. This is also in line with existing provisions on the cost of administering an RPA.

Chapter 4

Cost benefit analysis

4.1 In CP24/7, we set out our cost benefit analysis of the changes proposed, estimating their most significant impacts. We asked two questions:

Question 12: ***Do you have any comments on our cost benefit analysis?***

Question 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.***

4.2 In the following paragraphs, we provide a summary of the responses to these two questions. We combine the responses from the two questions because respondents often made similar points under both these questions.

4.3 A number of responses questioned the likely benefit that would arise from our proposals.

- One respondent suggested that MiFID II had caused a much greater reduction in use of research by investors compared to reduction in coverage of firms by research providers. This would suggest that our proposals could have a wider impact as the impact of MiFID was greater than we described in the CBA. This would imply greater scope for more material market take-up of the option than indicated in the CBA. In a similar vein, another respondent said that MiFID II had not delivered a more robust investment research market.
- Another respondent questioned why we are implementing a proposal where we think a small minority of firms will take up the options provided by our proposals and therefore where the benefits of such a change might be limited.
- One questioned whether the benefits envisaged in the CBA would occur given that the changes will only affect research targeted at actively trading investors, but research is important for a wider array of investors.
- Another suggested that it is not clear that there are any benefits to consumers at all from these proposals as any benefits will accrue to asset managers.

4.4 Some respondents also suggested that the costs for both buy-side and sell-side would be higher than those estimated. One respondent said that there will be material additional costs in accommodating how the proposals can fit with the requirements in other jurisdictions. In addition, there would also be ongoing costs to firms in the form of additional staff required to comply with the guardrails. Another respondent said that the buy-side would incur one-off costs from client and provider outreach to implement the new payment model. It was also suggested that more data would be needed from a wider array of market participants for cost estimates to be more robust.

4.5 A few respondents noted that CSA payments are often paid in arrears, and this has a considerable impact on the cashflow and working capital of research providers. This could have a knock-on effect on the breadth and availability of research under our proposals.

4.6 In our CBA, we said that sell-side firms will only offer the new option where they believe it is profitable for them to do so. One sell-side respondent said that they would need to build infrastructure to facilitate client demand, regardless of the number of buy-side firms that take up the option, or else be put at a competitive advantage.

4.7 One respondent questioned our evidence that fewer than 470 sell-side firms would be affected by our proposals.

4.8 One respondent asked about the timing of any work we intend to do to review firms' implementation of the policy, including any associated engagement with firms.

4.9 Finally, one respondent asked about the extent to which VAT payments had been considered within the CBA, and more specifically whether bundled research is exclusive of VAT.

Our response

We acknowledge that there is considerable uncertainty in the exact level of take-up and the benefits that arise from our proposals. There is also some uncertainty around the extent to which MiFID II impacted levels of analyst coverage and research use. In the CP, we observed that there have been changes in longer-term trends with respect to research coverage, and that MiFID II did not appear to change these trends. However, we do accept that the extent to which research is used could have been more affected.

While we expect some level of take-up of our proposals, it is far from clear the extent to which both buy-side and sell-side use this option. We agree that the proposals will not in themselves reverse the wider trends we have observed in the investment research market, nor materially increase research use by all investors. Our survey suggested relatively low levels of take-up, but this was prior to modifications we have since made to it, and the market could switch more significantly to using the new option.

Firms do have the option to use the new payment model or not. However, if a significant proportion of the market takes up the new option, then firms may find that they need to adjust their approach to retain market share and maintain profitability.

Investors, including final consumers, could face increased costs as asset managers pass additional costs on them. In our CBA we noted that the guardrails are designed to prevent buy-side firms passing the cost of low-quality or duplicative research back to investors. We also expect any efficiency benefits of procuring research will to some extent be passed on to investors.

We agree that the costs we reported in our CBA are not as robust as we would like. In the CBA, we explained that we had undertaken a survey of buy-side firms which included questions about the likely costs arising from potential policy options. However, we did not receive meaningful cost estimates from respondents. Increasing the sample size of the

survey would likely not have increased the quality of the responses. The costs we did estimate are averages for firms in each sector (or the firms that would take up the option). We always expect some firms to incur costs in excess of those we report. Without further quantitative evidence, we are unable to adjust our cost on the basis that a small number of firms think they are underestimated.

We do agree that there may be some additional ongoing costs to firms of maintaining the guardrails that we did not account for in the CBA. We did not receive any estimates on these ongoing costs and so it is hard to predict the extent of such costs. We do not think they are likely to be as large as the one-off IT, system and process costs of £4.9m we estimated.

We note the concern that respondents had about the effect of delayed cash flows on research providers' working capital. Our rules seek to prevent undue delays in payment for research. While delays in payments can have material impacts on individual firms, we do not expect delays in payment to materially affect the overall costs or benefits of our proposals.

We do not have more precise evidence on the exact proportion of the 470 sell-side firms that would be directly affected by our proposals because they offer both equity trading and research. Our cost estimates were based on the 470 firms in the CBA.

We set out our approach to assessing the impact of these proposals in paragraph 1.26 of this PS. We will consider undertaking a survey with a sub-set of the questions in our prior CP24/7 survey, after a reasonable period of time (e.g. five years) and comparing results versus the original survey. In any survey we conduct, we will seek to understand the costs and benefits that arose from our changes.

With regard to VAT, we are not in a position to opine on the tax payable on different payment options used by firms. This is a matter for firms and HMRC.

Taken together, the responses to the questions on the CBA suggest that the costs we estimated may be higher than we set out in the CBA. However, we do not have any additional evidence to quantify the extent of this underestimate. We have therefore not made any adjustments to the costs we presented. However, even in light of our comments, we still expect our proposal to be net beneficial. As we noted in the CBA, we expect asset managers would only take up the option where the expected benefit for them would outweigh the costs. This includes any costs passed through from sell-side firms as they facilitate the new option. Consequently, we expect take-up will to some extent be inherently proportionate as take-up will only happen where it is net beneficial. We are also making a small number of changes to the policy that we consulted upon. These are relatively technical in nature, and do not materially affect the overall costs and benefits of the changes, though they are likely to reduce the costs of initial implementation and ongoing maintenance.

Annex 1

List of non-confidential respondents

abrdn

Association of Foreign Banks (AFB)

Association Française de la Gestion financière (AFG)

Association for Financial Markets in Europe (AFME)

Association of Investment Companies (AIC)

Alternative Investment Management Association (AIMA)

AlphaValue

Aviva Investors

BlackRock

BTIG Limited

Capital Group

CFA Society UK

City UK

Commcise

Euro IRP

European Leveraged Finance Association (ELFA)

Financial Services Consumer Panel

Investment Association (IA)

Investor Relations Society

Lane Clark & Peacock LLP

Lansdowne Partners LP

Listcorp

Longspur Capital

London Stock Exchange Group (LSEG)

Managed Funds Association (MFA)

Morningstar

Personal Investment Management & Financial Advice Association (PIMFA)

Pensions and Lifetime Savings Association (PLSA)

Quoted Companies Alliance (QCA)

Royal London Asset Management

Small Business Practitioner Panel

T Rowe Price International

UK Equity Markets Association

UK Finance

Virtu Financial

Annex 2

Abbreviations used in this paper

AIFM	Alternative Investment Fund Manager
AIM	Alternative Investment Market
CBA	Cost Benefit Analysis
COBS	Conduct of Business sourcebook
CP	Consultation Paper
CSA	Commission Sharing Arrangement
EU	European Union
FCA	Financial Conduct Authority
FICC	Fixed Income Currencies and Commodities
FSMA	Financial Services and Markets Act 2000
IRR	Investment Research Review
IRP	Independent Research Provider
MiFID	Markets in Financial Instruments Directive
MiFID II	Markets in Financial Instruments Directive II
MNMB	Minor Non-Monetary Benefit
P&L	Profit and Loss
PRIIPS	Packaged Retail and Insurance-Based Investment Products
PS	Policy Statement
RPA	Research Payment Account
SBPP	Small Business Practitioners Panel
SCM	Standardised Cost Model

AIFM	Alternative Investment Fund Manager
SEC	Securities and Exchange Commission
SICGO	Secondary International Competitiveness and Growth Objective
SME	Small and Medium Enterprise
SRF	Smarter Regulatory Framework
UCITS	Undertakings for Collective Investment in Securities
UK	United Kingdom
US	United States
VAT	Value Added Tax
WMR	Wholesale Markets Review

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Appendix 1

Made rules (legal instrument)

PAYMENT OPTIONALITY (INVESTMENT RESEARCH) INSTRUMENT 2024

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the powers and related provisions in or under:

(1) the following sections of the Financial Services and Markets Act 2000 ("the Act"):

(a) section 137A (The FCA's general rules);
(b) section 137T (General supplementary powers);
(c) section 139A (Power of the FCA to give guidance);
(d) section 247 (Trust scheme rules); and
(e) section 261I (Contractual scheme rules); and

(2) regulation 6 (FCA rules) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).

B. The rule-making powers listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 1 August 2024.

Amendments to the Handbook

D. The Conduct of Business sourcebook (COBS) is amended in accordance with the Annex to this instrument.

Citation

E. This instrument may be cited as the Payment Optionality (Investment Research) Instrument 2024.

By order of the Board
25 July 2024

Annex

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

2 Conduct of business obligations

…

2.3A Inducements relating to MiFID, equivalent third country or optional exemption business and insurance-based investment products

…

Acceptable minor non-monetary benefits

2.3A.19 R An acceptable minor non-monetary benefit is one which:

…

(5) consists of:

…

(g) ~~research on listed or unlisted companies with a market capitalisation below £200m, provided that it is offered on a rebundled basis or provided for free. The market capitalisation is to be calculated with reference to the average closing price of the *shares* of the company at the end of each *month* to 31 October for the preceding 24 *months*. For companies newly admitted to trading, determination of the threshold should be based on the market capitalisation at the close of day one trading and apply until the date of the next re-assessment (i.e. 31 October). For these purposes, *firms* may reasonably rely on the assessment of a third party that the research is on a company with a market capitalisation below £200m;~~ [deleted]

…

(j) written material that is made openly available from a third party to any firm wishing to receive it or to the general public. "Openly available" in this context means that there are no conditions or barriers to accessing the written material other than those which are necessary to comply with relevant regulatory obligations, 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; ~~or~~

(k) *corporate access services* which relate to listed or unlisted companies with a market capitalisation below £200m ~~in accordance with *COBS* 2.3A.19R5(g).~~; or

(l) short-term trading commentary that does not contain substantive analysis, and bespoke trade advisory services intrinsically linked to the execution of a transaction in *financial instruments*.

…

…

2.3B Inducements and research

…

Receiving third party research without it constituting an inducement

2.3B.3 R Third party *research* that is received by a *firm* providing *investment services* or *ancillary services* to *clients* will not be an inducement under *COBS* 2.3A.5R, *COBS* 2.3A.15R or *COBS* 2.3A.16R if it is received in return for ~~either~~ one of the following:

(1) direct payments by the *firm* out of its own resources; ~~or~~

(2) payments from a separate *research* payment account controlled by the *firm*, provided that the *firm* meets the requirements in *COBS* 2.3B.4R relating to the operation of the account~~.~~; or

(3) joint payments for third-party *research* and execution services, provided that the *firm* meets the requirements in *COBS* 2.3B.25R to *COBS* 2.3B.33G relating to the operation of such joint payments.

…

…

Research for the purposes of research payment accounts and joint payments for research and execution services

2.3B.21 R A *firm* must only use monies in a *research* payment account established under *COBS* 2.3B.3R(2) to pay for *research* or to pay a rebate to *clients* in accordance with *COBS* 2.3B.8R(3)(a)~~.~~, and must use the separately identifiable *research* charge of joint payments for *research* and execution services under *COBS* 2.3B.3R(3) only to pay for *research*.

…

2.3B.23 G Examples of goods or services that the *FCA* does not regard as *research*, and as a result could not be paid for from *research* payment accounts or

joint payments for *research* and execution services, include:

…

(10) direct *money* payments; ~~and~~

(11) administration of a *research* payment account~~.~~; and

(12) administration of:

(a) an account for joint payments for *research* and execution services; or

(b) a *research* provider payment allocation structure.

2.3B.24 G A *firm* should not enter into any arrangements relating to the receipt of, and payment for, third party *research*, whether acquired in accordance with *COBS* 2.3B.3R(1) ~~or (2)~~, (2) or (3), that would compromise its ability to meet its best execution obligations as applicable under *COBS* 11.2A.

2.3B.25 R The requirements referred to in *COBS* 2.3B.3R(3) for the operation of joint payments for third-party *research* and execution services are:

(1) the *firm* must have a written policy on joint payments that:

(a) describes the *firm's* approach to joint payments, and how the *firm* will ensure compliance with the requirements in *COBS* 2.3B.25R(2) to *COBS* 2.3B.33G; and

(b) specifies how the *firm's* governance, decision-making and controls in respect of third-party *research* purchased using joint payments operate, including how these are maintained separately from those for trade execution;

(2) the *firm* must establish arrangements which stipulate the methodology for how the *research* costs will be calculated and identified separately within total charges for such joint payments;

(3) the *firm* must have a research provider payment allocation structure for the allocation of payments between different *research* providers, including:

(a) third-party providers of *research* and execution services; and

(b) *research* providers not engaged in execution services and not part of a financial services group that includes an *investment firm* which offers execution or brokerage services;

(4) the *firm* is fully responsible for:

(a) the administration of accounts for purchasing *research* from joint payments;

(b) ensuring that the operation of such accounts do not interfere with the compliance of the *firm's* obligations under this chapter; and

(c) ensuring timely payments to *research* providers;

(5) the *firm* must set a budget for the purchase of *research* using joint payments:

(a) based on the expected amount needed for third-party *research* in respect of *investment services* rendered to its *clients*, and not linked to the expected volumes or values of transactions executed on behalf of *clients*; and

(b) at least annually, and at a level of aggregation that is:

(i) appropriate to its investment process, *investment* products, *investment services,* and *clients*; and

(ii) does not compromise its ability to meet the requirements of *COBS* 2.3B.25R(6) and (8).

(6) the *firm* must allocate the costs of *research* purchased using joint payments fairly between *clients*;

(7) the *firm* must periodically, but at least annually:

(a) assess the value, quality and use of *research* purchased using joint payments and its contribution to the investment decision-making process; and

(b) ensure that the amount of *research* charges to *clients* is reasonable compared with those for comparable services; and

(8) the *firm* must disclose to its *clients* the items listed in *COBS* 2.3B.30R.

2.3B.26 R If the amount of *research* charges to *clients* exceeds the budget set out under *COBS* 2.3B.25R(5), or the budget is increased, the *firm's* policy must set out:

(1) the relevant actions to be taken in such circumstances; and

(2) the information to be disclosed to *clients*.

2.3B.27 G For the purposes of *COBS* 2.3B.25R(6), the *firm* should determine a cost allocation level appropriate to its business model. The specific cost of individual investment *research* items need not be discretely attributable to

individual *clients*. The approach should be reasonable and its outcome fair across all *clients*, such that relative costs incurred are commensurate with relative benefits received. This includes:

(1) across:

(a) *clients* with which the *firm* has different payment arrangements for the purchase of *research*;

(b) *clients* that are managed according to similar investment strategies; and

(c) different *clients* or groups of *clients* that benefit from the same *research*; or

(2) across other allocation levels provided that these are appropriate to a *firm's* investment process, *investment* products, *investment services*, and *clients*.

2.3B.28 R Where a *firm* delegates the administration of a *research* provider payment allocation structure or joint payments *research* account, it retains responsibility for complying with the requirements for its administration under this chapter. The *firm* must ensure that the reconciliation and reporting for such accounts and structures is undertaken with an appropriate frequency and timeliness, and continue to monitor and manage risks from unspent surplus amounts and *research* provider concentrations of these surplus amounts.

2.3B.29 R *Research* services must not be treated as an *execution factor* under *COBS* 11.2A.2R.

2.3B.30 R For the purposes of *COBS* 2.3B.25R(8), the *firm* must disclose to relevant *clients*:

(1) the *firm's* use of joint payments for *research*, including, where relevant, how the use of joint payments is combined with the use of other payments permitted under *COBS* 2.3B.3R;

(2) the key features of the *firm's* policy on joint payments in *COBS* 2.3B.25R(1), or the policy itself, having regard to the information needs of its *clients*. This information must be communicated to them in a way which is clear, fair and not misleading;

(3) the expected annual costs to the *client*, provided as part of ex ante disclosures on costs and charges, and based on the most appropriate of either:

(a) the budget-setting and cost allocation procedures set out in *COBS* 2.3B.25R(5), *COBS* 2.3B.25R(6) and *COBS* 2.3B.27G; or

(b) the actual costs for prior annual periods disclosed under *COBS* 2.3B.30(5);

(4) the most significant of the items in (a) and (b), at a level of aggregation appropriate to the *firm's* investment processes, *investment* products, *investment services* and *clients*:

(a) benefits and services received from *research* providers (measured by total amounts paid); and

(b) types of *research* providers from which such services are purchased;

(5) the total costs incurred by the *client*, disclosed on an annual basis, reflecting the total payments made for *research* purchased using joint payments over that period, and provided as part of ex post reporting on costs and charges; and

(6) where relevant, the disclosures set out in *COBS* 2.3B.26R(2).

2.3B.31 R For the purposes of the disclosures in *COBS* 2.3B.25R(8), *firms* must make the disclosures in:

(1) *COBS* 2.3B.30R(1) to (4) before providing an *investment service* or *ancillary service*, and thereafter upon request, and at least annually;

(2) *COBS* 2.3B.30R(5) as part of the *firm's* costs and charges disclosures, separately identifying joint payment *research* charges in such disclosures; and

(3) *COBS* 2.3B.30R(6) as soon as reasonably practicable, and in any case in the *firm's* next periodic disclosure to *clients* on costs and charges.

2.3B.32 G For the purposes of disclosing the types of *research* providers from which services are purchased under *COBS* 2.3B.30R(4)(b), a *firm* may provide a breakdown (measured by total amounts paid) according to the *research* provider types specified in *COBS* 2.3B.25R(3).

2.3B.33 G For the purposes of ensuring that *research* charges to *clients* are reasonable under *COBS* 2.3B.25R(7)(b), a *firm* may benchmark prices paid for *research* services purchased using joint payments against relevant comparators.

…

18 Specialist Regimes

…

18 Annex Research and inducements for collective portfolio managers

1R

…			
4	Inducements and research		
…			
	Disapplication of disclosure provisions		
4.7	R	The following provisions do not apply and references to them in *COBS* 2.3B are to be ignored:	
		…	
		(6)	…
	Disapplication and modification of provisions relating to joint payments for research		
4.7A	R	The following provisions also do not apply and references to them in *COBS* 2.3B are to be ignored:	
		(1)	*COBS* 2.3B.3R(3);
		(2)	*COBS* 2.3B.23G(12);
		(3)	*COBS* 2.3B.25R;
		(4)	*COBS* 2.3B.26R;
		(5)	*COBS* 2.3B.27G;
		(6)	*COBS* 2.3B.28R;
		(7)	*COBS* 2.3B.29R;
		(8)	*COBS* 2.3B.30R;
		(9)	*COBS* 2.3B.31R;
		(10)	*COBS* 2.3B.32G; and
		(11)	*COBS* 2.3B.33G.
4.7B	R	Where *COBS* 2.3B applies to a *firm*, the following modifications apply:	
		(1)	in *COBS* 2.3B.21R, the words 'and must use the separately identifiable *research* charge of joint payments for *research* and execution services under *COBS* 2.3B.3R(3) only to pay for *research*' are omitted; and

		(2)	in *COBS* 2.3B.23G, the words 'or joint payments for *research* and execution services' are omitted.
…			

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