

5 June, 2024

By email: cp24-7@fca.org.uk

Financial Conduct Authority
12 Endeavour Square London
E20 1JN

Re: Payment Optionality for Investment Research: Consultation Paper (CP 24/7)

Dear Sir/Madam,

MFA¹ appreciates the opportunity to represent the views of the global alternative investment industry in this written response to the Financial Conduct Authority's ("FCA") consultation paper on payment optionality for investment research (the "**Consultation Paper**"). We have set out our responses to the relevant questions of the Consultation Paper in the Annex hereto.

In summary, MFA welcomes the proposed new option to allow the 'bundling' of payments for third-party research and execution services, alongside the existing research payment options. However, MFA is concerned that the proposed guardrails associated with the new payment option may be a deterrent to its adoption by firms, and that this may hinder the achievement of the objectives of the proposal, including the promotion of competition and facilitation of UK firms' ability to procure research on an international basis. We highlight these matters in our responses below.

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¹ Managed Funds Association (MFA), based in Washington, DC, New York, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 180 member fund managers, including traditional hedge funds, credit funds, and crossover funds, that collectively manage over \$3.2 trillion across a diverse group of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time.

Washington, DC
1301 Pennsylvania Ave NW
Suite 350
Washington, DC 20004

New York
546 5th Avenue
12th Floor
New York, NY 10036

Brussels
40 Rue D'Arlon
1000 Brussels, Belgium

London
14 Hanover Square, Mayfair,
London, United Kingdom, W1S 1HT

MFA appreciates the opportunity to provide these comments to the FCA in response to the Consultation Paper. If you have any questions about these comments, or if we can provide further information, please do not hesitate to contact Jeff Himstreet (jhimstreet@mfaalts.org) or the undersigned (jhan@mfaalts.org).

Respectfully submitted,

/s/ Jennifer W. Han

Jennifer W. Han
Executive Vice President and Chief Counsel
Global Regulatory Affairs
Managed Funds Association

ANNEX

CHAPTER 1. SUMMARY

Q1a Do you agree with our proposal to create additional payment optionality for investment research?

MFA Response

Yes.

Q1b If yes or no, please explain your views.

MFA Response

MFA supports the FCA's proposal to introduce additional payment optionality for investment research.

MFA concurs with a number of the observations noted in the Consultation Paper as underlying drivers for the proposal. In particular, MFA agrees that the current investment research payment options - payment out of own resources (the "**P&L model**") or from a research payment account ("**RPA**") - have negatively impacted UK asset managers' ability to procure research on an international basis, to the potential detriment of investment performance and UK asset managers' ability to compete on a global basis. MFA also agrees with the FCA's observations that the uptake by firms of the RPA model has been limited, due to the operational complexity and resource-intensive nature of maintaining an RPA.

That said, MFA also supports the underlying rationale for the unbundling of investment research, which has resulted in greater transparency of execution and research costs. To that end MFA is supportive of the proposed new payment option as an additional option to the P&L model and the RPA model, rather than having the proposed new payment option simply replacing the existing models.

Q2a Would you be likely to take advantage of the proposed new payment option?

MFA Response

Please see response to Question 2b below.

Q2b If yes or no, please explain your views.

MFA expects that, while some of its Members may consider adopting a bundled payment option, the uptake of the bundled payment option by firms will depend on whether the associated guardrails work smoothly. Please refer to our response to Question 8b below for our views on this point.

CHAPTER 2. THE WIDER CONTEXT

Q6a. 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?

Please see our response to Question 6b below.

Q6b. If yes or no, please explain your views.

While MFA recognizes and supports the FCA's aim to increase alignment with the research rules in other key jurisdictions (such as the US and EU), and to remove barriers which prevent UK asset managers from paying for investment research in other jurisdictions where payment on a bundled basis is standard practice, we do not consider that these objectives would be achieved by the new payment option as proposed, given the extent of the proposed guardrails.

For example, the obligation to ensure separate identification of research costs in the firm's written agreement with research providers, as well as the requirement for ex post reporting to clients on research costs incurred, would give rise to challenges where the firm engages providers based in jurisdictions, such as the US, that do not require brokers to unbundle research and execution costs. In such a scenario, the US broker could not be expected to have procedures in place to allow for it to separately identify research costs. As a result, UK asset managers would continue to be prevented from engaging research providers in the US.

CHAPTER 2. OUR PROPOSALS

Q8a. Are there any features of the proposed payment option and associated guardrails that would positively or negatively impact its take-up by firms?

Yes.

Q8b. If yes or no, please explain your views.

MFA welcomes granting additional flexibility to firms in their approach to research payment. However, MFA considers that the benefits of increased payment optionality that the FCA seeks to achieve could be undermined if there is insufficient uptake by firms of the new payment option.

In particular, MFA notes that the proposed guardrails are significantly more burdensome than the changes to the MiFID research payment rules in the EU proposed pursuant to the Listing Act Directive². While the EU's proposals similarly allow an investment firm to make bundled payments subject to meeting certain requirements (such as establishing a policy on bundled payments, informing clients of such policy, and assessing the quality of research on an annual basis), the guardrails under the EU regime do not include any of the following elements:

- a requirement on firms to ensure that written agreements with research and execution service providers establish a methodology for the calculation of research costs and their separate identification within total charges;
- a requirement to have a research payment allocation structure;
- full responsibility being placed on the firm for the administration of accounts for purchasing research and for timely payments to research providers;
- a requirement to set a budget for research;
- a requirement to ensure fair allocation of payments between clients;
- a requirement to undertake price benchmarking; or
- detailed client-facing disclosures. Notably, total research costs incurred by the firm under the EU's proposals need only be recorded internally, where known to the firm (allowing for the fact that overseas research providers may not provide separate identification of their research costs to the firm) and only disclosed to the firm's clients on request.

As a general matter, we consider the extent of the list above to highlight that UK asset managers would be subject to a significantly more burdensome set of requirements than EU asset managers – and consequently at a competitive disadvantage in their ability to purchase research on a global

² Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/65/EU to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises and repealing Directive 2001/34/EC (2022/0405 (COD)) (<https://data.consilium.europa.eu/doc/document/ST-6252-2024-INIT/en/pdf>).

basis - if the more extensive set of guardrails associated with the bundled payment option were retained in its current form.

However, focusing on potential issues associated with certain specific guardrails, MFA is of the view that the following features could negatively impact the take-up by firms of the new payment option:

- The requirement that written agreements with research providers and execution service providers establish a methodology for the calculation and separate identification of research costs within total charges for bundled payments
 - While MFA views the requirement to enter into written agreements with research providers and execution service providers as an appropriate guardrail, MFA considers that the requirement for the firm's written agreement to establish a methodology for the calculation and separate identification of research costs may limit firms' ability to engage research and execution providers based in overseas jurisdictions.
 - Whilst brokerage firms authorised under MIFID, as implemented in the UK³ or in EU Member States⁴, are subject to a requirement to separately identify charges for execution and research services, equivalent requirements do not apply in other jurisdictions. The proposed requirement discussed above may therefore diminish the extent to which the new payment option would facilitate asset managers accessing research globally, to the detriment of the FCA's secondary international competitiveness and growth objective.

MFA therefore respectfully requests that the proposed wording of COBS 2.3B.25R(2) be amended as follows:

the firm must enter into written agreements with research and execution service providers which establish a methodology for how the research costs will be calculated and identified separately within total charges for such joint payments;

- The requirement to ensure timely payments to research providers
 - MFA acknowledges that the proposed requirement on firms to ensure timely payment to research providers is underpinned by an aim to foster financial resilience within the research market⁵, and recognises the importance of this objective.

³ Pursuant to COBS 2.3C.2R.

⁴ Pursuant to Article 13(9) of Commission Delegated Directive (EU) 2017/593, as implemented under local Member State law.

⁵ As noted in paragraph 4.40 of the Consultation Paper.

- However, MFA is of the view that the timeliness of payments by firms to research providers, and the implications of late payments, is a commercial matter to be agreed between the firm and the relevant provider in their contractual arrangements. Firms may be deterred from adopting the new payment option on the basis the timeliness of their payments to research providers would become a matter of FCA regulation, as opposed to simply being a contractual obligation towards the relevant service provider.
- The requirement to undertake price benchmarking to ensure research charges are reasonable compared to those for comparable services
 - MFA supports the aim of ensuring the costs of research are sufficiently weighed against the benefits to clients, in its contribution to the investment process. Accordingly, MFA agrees with the general requirement on firms to periodically assess the value, quality and use of research purchased. MFA notes that this aligns with the EU's proposals, as discussed above.
 - However, MFA considers the requirement to ensure, through benchmarking, that “the amount of research charges to clients are reasonable compared to those for comparable services” could give rise to significant uncertainty for firms. Where lower cost research providers are identified through benchmarking, firms may consider themselves obliged to switch providers to comply with this rule. However, regular switching of providers may not be in the best interest of clients, in particular as a benchmarking exercise would generally only indicate lower cost alternatives in the market, rather than a holistic assessment of those alternatives, and may result in a firm switching to a provider whose services are in other ways less suitable for the firm (for example, in terms of the quality or nature of the research).
 - Moreover, MFA notes that, for firms subject to the Consumer Duty, the proposed requirement to ensure research charges are reasonable is duplicative of existing requirements under the price and value outcome to ensure the firm's products, including any charges or fees borne by the client, provide fair value.
 - MFA would therefore respectfully request that the FCA consider revising the proposed requirement in COBS 2.3B.25R(7)(b) to clarify that a firm is not obliged to switch providers if it finds a lower cost alternative, if it considers its incumbent

provider to remain an appropriate option based on other factors, such as the quality of the incumbent provider's research.

- Disclosure to clients
 - MFA recognises the importance of adequate disclosure to clients to ensure clients' ability to have sufficient information to support good decision-making on their choice of asset manager, as well as ensuring spending discipline by making firms accountable to clients on costs incurred.
 - However, MFA considers that the benefit of such disclosures are more limited in certain contexts; in particular:
 - where the firm provides investment services on an intra-group basis, that is, to an affiliated entity – for example, many a MiFID investment management firm might be providing sub-management services to its parent, a US alternative investment fund manager, in relation to certain funds managed by that parent. In such circumstances, MFA considers that the extent of proposed client disclosures and ongoing reporting may be disproportionate to the benefit such disclosures would have for an affiliated client. In this regard, MFA notes that issues of accountability for costs and of supporting a client's ability to choose among different asset managers are of limited relevance where the client in question is an affiliated entity; and
 - where the firm provides investment services to professional clients, noting that the sophistication of such clients is safeguarded via the conditions that must be met for a firm to be permitted to classify a client as such under COBS 3.5.
 - To address the above, MFA respectfully requests that the proposed client disclosures and reporting be amended to provide that firms can agree with professional clients, and with clients that are affiliated entities, to a limited application of the proposed disclosure obligations. MFA notes that there is a precedent for this type of provision, notably in the FCA rules that implemented the MiFID ex post costs and charges reporting requirements⁶, which allowed firms to agree with professional clients to a more limited set of reporting requirements. MFA considers that an amendment to this effect would help ensure the disclosure requirements of the new payment option can be applied

⁶ Article 50(1) Commission Delegated Regulation (EU) 2017/565.

in a manner that is proportionate to the nature of the firm's clients and business, and that the requirements do not discourage firms from adopting the option.

Q9a. Do you agree with the proposed addition of short-term trading commentary and advice linked to trade execution to the list of acceptable minor non-monetary benefits in COBS 2.3A.19R(5)?

Yes.

Q9b. If yes or no, please explain your views.

MFA agrees with the proposed addition of short-term trading commentary and advice linked to trade execution to the list of acceptable minor non-monetary benefits for the reasons the FCA highlights in the Consultation Paper. In particular, MFA agrees that this amendment is necessary to avoid differences in access to research, to the detriment of the existing payment options.

Q10a. 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)?

No.

Q10b. If yes or no, please explain your views.

MFA acknowledges that the FCA's industry survey sample indicated limited uptake for the option for bundled payments to purchase research on companies with a market capitalisation below £200 million.

However, MFA would highlight that certain firms have indeed taken up the option to re-bundle payments for research on SMEs below £200 million market capitalisation following the rule change. As such, deletion of this item from the list of acceptable minor non-monetary benefits would require such firms to revert to an unbundled payment model for research on SMEs if they continue to pay for research out of their own resources, rather than adopting the new bundled payment option. MFA considers that this result would be contrary to the aims of the Consultation Paper.