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

About TheCityUK

TheCityUK is the industry-led body representing UK-based financial and related professional services. We champion and support the success of the ecosystem, and thereby our members, promoting policies in the UK and internationally that drive competitiveness, support job creation and enable long-term economic growth. The industry contributes 12% of the UK's total economic output and employs over 2.4 million people – with two thirds of these jobs outside London across the country's regions and nations. It pays more corporation tax than any other sector and is the largest net exporting industry. The industry plays an important role in enabling the transition to net zero and driving economic growth across the wider economy through its provision of capital, investment, professional advice and insurance. It also makes a real difference to people in their daily lives, helping them save for the future, buy a home, invest in a business and manage risk.

TheCityUK's Capital Markets Group brings together a broad range of experts from across the capital markets and listing ecosystem and interested parties, with senior practitioners from the buy side, sell side, intermediaries, and industry bodies. The group brings together these voices to reflect the cross-industry nature of the financial and related professional services industry's role in this ecosystem.

Introducing additional payment optionality for investment research

Overview

In CP 24/7 the FCA set out further detail on how it intends to implement new rules to permit payment optionality for investment research.

TheCityUK continues to support the reintroduction of payment optionality for research, and encourages the FCA to implement this change as soon as feasible and in as practical a manner as possible. There are concerns in several quarters that the guardrails being proposed are likely to be more onerous than those imposed in other jurisdictions, and may be too onerous to encourage significant adoption of payment optionality. This paper provides a high-level cross-industry perspective on the FCA's proposals.

Will the new rules encourage firms to use a re-bundled structure to pay for research?

A key test for the FCA's proposed new regime will be whether or not it encourages firms to take advantage of the new optionality. To support re-bundling, the FCA is proposing to introduce a number of so called 'guardrails' to help ensure the interests of investors continue to be protected. TheCityUK acknowledges

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the need to ensure the interests of all parties are considered in any rebundling proposals and supports the principle of proportionate guardrails that can be used to protect the interests of investors.

However, for firms to take advantage of the new optionality it will be necessary to ensure that the implementation of any such guardrails is proportionate and not overly burdensome. The guardrails are more extensive than the requirements in other jurisdictions. This may put UK firms at an international competitiveness disadvantage when it comes to purchasing and preparing research. There is, therefore, a real risk that the guardrails will require too much additional operational build-out for research producers, research purchasers and execution providers. This would, in turn, mean that there may be limited incentive for firms to adopt the new rebundled model in replacement of models implemented as part of MiFID II.

In particular, where managers and brokers operate a cross-border business they may be impacted by multiple regulatory regimes in respect of payment for research, with divergent regulatory requirements. If each such regime requires a separate and prescribed operational build to support it this will lead to unhelpful and expensive operational complexity, which could hinder firms' willingness to engage with the FCA's proposed new payment method. This could also serve as a barrier to entry for smaller firms, who would be disproportionately impacted by these operational cost concerns.

At this time, there are many industry participants who believe that take-up of this payment optionality will be limited based on the existing understanding of the proposed guardrails and disclosures, and the steps that will be required to comply with the proposed guardrails.

Practicality of guardrails

The FCA's proposed guardrails cumulatively impose a significant number of additional obligations on firms to enable them to support payment optionality. We would encourage the FCA to consider whether or not all of these obligations are necessary, and whether these obligations impose a greater burden on UK firms than is imposed in the EU and the US.

Measure of success

We note that the FCA has cited the number of firms using the new payment method as a key indicator of success. While that will be a part of the success, we would ask the FCA to consider whether any of the wider objectives of the reforms to investment research should also be considered as part of the assessment of success of the new proposals. Namely it may also be helpful to consider the impact of the proposals on the quality, range, volume and jurisdiction of research purchased, particularly in relation to small and mid-cap issuers.

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The number of firms using the new payment method is also likely to vary between different segments of the asset manager market. So any measure of success should reflect that uptake for the new payment method may be concentrated to particular types of managers, and this should not necessarily be considered a negative outcome of the regime.

Conclusion

This paper sets out continued industry-wide support for reintroduction of payment optionality for research Further careful calibration of the guardrails and the proportionality of the additional burden imposed by the guardrails will be needed before any changes are implemented. We look forward to continuing to work closely with the FCA on refining the UK's regulatory regime for research.

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