

MEMO# 28121

May 15, 2014

U.K. FCA Issues Policy Statement on Changes to the Use of Dealing Commission Rules; Member Call on May 19 at 11 am EST

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TO: SEC RULES COMMITTEE No. 19-14
EQUITY MARKETS ADVISORY COMMITTEE No. 7-14
ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 8-14
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 20-14
INTERNATIONAL COMMITTEE No. 15-14
ICI GLOBAL STEERING COMMITTEE No. 8-14
ICI GLOBAL REGULATED FUNDS COMMITTEE No. 4-14 RE: U.K. FCA ISSUES POLICY STATEMENT ON CHANGES TO THE USE OF DEALING COMMISSION RULES; MEMBER CALL ON MAY 19 AT 11 AM EST

On May 8, 2014 the U.K.'s Financial Conduct Authority (FCA) issued a Policy Statement that finalizes "clarifications" to the FCA's rules on the use of dealing commissions by investment managers. [\[1\]](#) The Policy Statement follows the FCA's November 2013 consultation on this issue, on which ICI Global commented. [\[2\]](#) The FCA maintains that the proposals merely clarify existing expectations rather than create new requirements and that firms that are already complying with the rules will not need to make significant changes to their business model. The FCA notes, however, that firms may want to change their internal policies and procedures to reflect the new wording in the rules. The changes come into effect on June 2, 2014.

Below is a brief summary of the changes described in the Policy Statement. We will hold a member call on Monday, May 19 at 11 am EST to discuss the changes and members' reactions. The dial-in information is below. Please r.s.v.p. to Ruth Tadesse (rtadesse@ici.org) to let us know if you plan to participate.

From the U.S.: 1-888-469-1086

From outside the U.S.: 1-630-395-0255

Exemption Permitting the Use of Dealing Commission and “Reasonable Grounds”

The FCA explained in the Policy Statement that there are three parts to the exemption permitting the use of dealing commission: an investment manager must have reasonable grounds to be satisfied that a good or service paid for with dealing commissions will reasonably assist them with the service provided to their customers; receipt of the good or service must not impair their duty to act in their customer’s best interests; and the good or service must either be directly related to execution or amount to the provision of substantive research. To ensure clarity of these requirements, the FCA revised the proposal and redrafted the requirements as COBS 11.6.3R(3).

The FCA returned to the original language regarding “reasonable grounds” in relation to an investment manager’s satisfaction that a good or service received in return for dealing commissions “will reasonably assist” them in providing its services to its customers. However, the FCA maintained the change removing “reasonable grounds” in relation to both whether the investment manager’s receipt of a good or service impairs compliance with the duty to act in the best interests of customers, and whether a good or service is either directly related to the execution of trades or amounts to the provision of substantive research. The FCA stressed that it expects firms to have sufficient systems, controls and recordkeeping in place to enable firms to meet and demonstrate compliance with its requirements.

The Evidential Criteria for Substantive Research

The FCA kept the changes that it proposed in the consultation in COBS 11.6.5E(1)(d), requiring that the research “present the investment manager with meaningful conclusions based on analysis or manipulation of data.” The FCA explained, though, that this is not intended to limit a conclusion to a buy or sell recommendation, and that this does not exclude non-written formats. Further, the FCA explained that the term “meaningful” does not infer that the investment manager has to agree with and follow the conclusions in order for it to be considered substantive research, and that such research may be used to feed into a firm’s own further research or assessment of trading ideas.

Importantly, the FCA provided that, if an investment manager receives research that will never be used at all, even if it could meet the criteria for substantive research, this would not meet the standard of “reasonably assisting” the investment manager and could not be charged to customers.

Corporate Access

The FCA determined that the definition of “corporate access” that it proposed was appropriate and did not make any changes from the consultation. Responding to commenters’ questions and concerns, the FCA addressed the issue of corporate access as part of a bundled service, including an unpriced bundled service, by amending and expanding the guidance provided in COBS 11.6.8 AG. The FCA stressed that, in each case, the investment manager should take steps to identify and disaggregate the discrete element of substantive research within the bundled service from any non-eligible elements such as corporate access, and make a fair assessment of the charge it should pass on to its customers through dealing commissions for the acceptable part. The FCA noted that an investment manager can still pay for other, non-eligible elements of a conference or field

trip, such as corporate access, other than through dealing commission.

The FCA also addressed the issue raised by commenters of corporate access as a non-monetary benefit (where the investment manager genuinely views the meeting as free). The FCA acknowledged that such scenarios may be encountered by investment managers and stated that in such situations they would expect investment managers to consider the regulatory requirements and be able to demonstrate to the FCA that they have acted consistently with the FCA's rules.

Guidance on Mixed-Use Assessments

To address questions regarding the application of the proposed new guidance on mixed assessments to unpriced bundled services, the FCA added an additional paragraph at COBS 11.6.8AG that provides that, in such case, the investment manager should make a "fair assessment" of the charge that it would be permitted to pass on to its customer and that, in making such determination, an investment manager may need to consider whether it can carry out a fact-based analysis of the unpriced good or service.

The FCA declined to set out a preferred "methodology" for mixed-use assessments. It did, however, provide some further guidance on alternative approaches a firm may wish to take when making mixed-use assessments at COBS 11.6.8AG(2). The FCA noted that, as long as a firm can evidence that they have a clear, rational process that puts a strong emphasis on ensuring their customers' best interests are central in their assessments, this should be acceptable.

Territorial Scope and Interaction with Other Regulatory Regimes

Addressing questions regarding how COBS 11.6 should be applied in cross border situations, the FCA began by stating that the proposed changes do not affect the existing territorial application of COBS and that firms must already consider the application of the FCA's rules to their business activities. The FCA noted, however, that, as set out in its supervision manual, the FCA will continue to have regard for the context in which a firm operates where it undertakes business internationally.

Developing a Taxonomy of Goods and Services

The FCA stated that it does not intend to produce a detailed taxonomy of goods and services, nor otherwise suggest that particular groups of products are acceptable under the use of dealing commission rules beyond the indication of non-permitted items currently set out in the rules. The FCA further stated that it would also risk third parties seeking to label a good or service to enable or encourage an investment manager to acquire it using dealing commissions. However, the FCA explained that if firms or trade associations wished to develop a common taxonomy of goods or services to aid their members, the FCA would be open to engaging with such an initiative.

Annual Attestations

The FCA stated that it does not propose to explore the option of a regular, annual attestation from CEOs at this time.

Next Steps

The FCA explained that their debate and work has been framed in the context of ongoing EU negotiations to revise MiFID, and that the FCA is also actively engaging with other international regulators through IOSCO. The FCA stated that it expects to report back on its work on wider reform later in 2014 and that if a need for further reform is identified, any

such changes will be aligned with the FCA's domestic implementation of MiFID, likely in late 2016 or early 2017, in order to minimize the uncertainty and potential cost of any changes for firms.

Eva M. Mykolenko
Associate Counsel - International Affairs

endnotes

[1] The Policy Statement is available at <http://www.fca.org.uk/your-fca/documents/policy-statements/ps14-07>.

[2] ICI Global's comment letter is available at <http://www.ici.org/pdf/27918.pdf>.

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