

MEMO# 27918

February 26, 2014

ICI Global Comment Letter on FCA Consultation on Dealing Commission Rules

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TO: SEC RULES COMMITTEE No. 7-14

EQUITY MARKETS ADVISORY COMMITTEE No. 4-14

ETF (EXCHANGE-TRADED FUNDS) COMMITTEE No. 4-14

CLOSED-END INVESTMENT COMPANY COMMITTEE No. 6-14

INTERNATIONAL COMMITTEE No. 4-14

ICI GLOBAL STEERING COMMITTEE No. 3-14

ICI GLOBAL REGULATED FUNDS COMMITTEE No. 1-14 RE: ICI GLOBAL COMMENT LETTER ON FCA CONSULTATION ON DEALING COMMISSION RULES

On February 25, 2014, ICI Global submitted the attached letter responding to the UK Financial Conduct Authority's (the "FCA") consultation on dealing commission rules (Consultation). [\[1\]](#) In the Consultation, the FCA proposes to (i) prohibit the use of dealing commission to purchase "corporate access," (ii) revise the criteria for determining the characteristics of exempt research, ultimately creating a more objective standard, and (iii) require disaggregation for services where substantive research is provided alongside another good or service that is not permitted to be paid for through the use of dealing commission. The Consultation also seeks feedback regarding the potential for wider reforms to the dealing commission regime.

The letter notes that, as an initial matter, while the FCA states that the purpose of the Consultation is to clarify existing rules, we strongly believe that the proposals go beyond mere clarification and mark a significant shift in the FCA's interpretation of these issues. Implementing these changes may for some firms require a substantial reworking of their trading and research operations and systems, as well as their policies and procedures relating to dealing commission. The letter then raises a number of issues and provides recommendations, described briefly below, for the FCA to consider as it implements any reforms to its dealing commission rules.

Understanding of Global Regulations on Dealing Commission

The letter states that, prior to implementing any reforms, the FCA must fully understand how jurisdictions around the world regulate the use of dealing commission, as well as how global investment management firms operate in today's complex trading environment. It

further states that IOSCO is well-placed to serve as a forum for facilitating the aggregation of information regarding the various regulatory regimes applicable to dealing commission and encourages IOSCO to update its prior work on dealing commission arrangements.

Global Nature of Investment Management Industry

The letter discusses the global nature of today's investment management industry and explains that the FCA must take this into consideration as it evaluates reforms to the dealing commission regime. A marked regulatory divergence from established practices would, in our view, pose significant challenges for investment managers because it would be difficult for investment management firms to maintain integrated research and trading operations.

Concerns Regarding Proposed Changes and Potential Consequences

Recognizing that the FCA may determine to proceed with the reforms it proposes in the Consultation, and subsequently with wider reforms to its dealing commission rules, the letter raises certain questions and issues for the FCA's consideration.

Impact on Small and Medium-Sized Investment Managers. The letter raises concerns that the proposed change to corporate access will reduce access to issuers, particularly for small and medium-sized investment managers and recommends that the FCA gather data and undertake further analysis of this issue.

Corporate Access – Incidental Assistance. The letter explains that, in certain circumstances, a broker may provide incidental assistance in arranging corporate access for an investment manager, even though the investment manager does not pay the broker for corporate access out of brokerage commission and does not use corporate access as criteria in evaluating its brokers' performance in its broker poll. The letter recommends that the FCA clarify how the dealing commission and inducements rules apply to situations where a broker may provide such "incidental assistance" in arranging corporate access for an investment manager, e.g., access that is not paid for out of dealing commission and not recharged to clients.

Revisions to Definition and Interpretation of Research. The letter recommends that the FCA should not proceed with proposed changes to the research exemption eliminating the "reasonable grounds" standard under which investment managers currently operate. To the extent the FCA proceeds with revisions, the letter states that the FCA should: (1) clarify that application of the criteria to determine what is "substantive research" is subjective; (2) explicitly include any items that are not permitted to be treated as exempt research on the list of items that are not exempt for clarity; and (3) confirm that investment managers can use a "proportional approach" to determine what is "substantive research."

Necessity of Sell-Side Engagement. The letter states that the sell-side is integral in the dealing commission regime and that engagement with the sell-side is key to achieving a response that improves transparency and market integrity in this area. The letter therefore recommends that the FCA should not move forward with its proposals until, and unless, it also requires the sell-side to provide information to investment managers necessary to facilitate compliance with any changes.

Clarify Jurisdictional Application. The letter recommends that the FCA give consideration to the jurisdictional application of its new regime, and unless and until there is international regulatory convergence, clarify that any new rules will only apply on a narrow basis so as to minimize any issues that may arise.

Considerations with Respect to Wider Reforms to the Dealing Commission Regime

The Consultation seeks feedback regarding the potential for wider reforms to the dealing commission regime. The letter recommends that the FCA consider refinements to the current dealing commission regime rather than adopting a more radical approach that further restricts or eliminates the use of dealing commission to purchase research. It further recommends that the FCA issue a consultation requesting comment on any changes prior to taking further action with respect to dealing commission; in this manner, the FCA can consider the impact of reforms on investment managers.

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[Attachment](#)

endnotes

[1] The FCA consultation paper (CP13/17) is available at:
<http://www.fca.org.uk/static/documents/consultation-papers/cp13-17.pdf>.

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