

MEMO# 15922

April 22, 2003

UK FSA ISSUES CONSULTATION PAPER ON BUNDLED BROKERAGE AND SOFT COMMISSION ARRANGEMENTS

[15922] April 22, 2003 TO: SEC RULES COMMITTEE No. 34-03 RE: UK FSA ISSUES CONSULTATION PAPER ON BUNDLED BROKERAGE AND SOFT COMMISSION ARRANGEMENTS

Recently, the UK Financial Services Authority (FSA) issued a consultation paper on bundled brokerage and soft dollar arrangements (Consultation Paper).¹ The Consultation Paper responds to the March 2001 report on pension funds by Paul Myners for HM Treasury, which concluded that there was an incentive for pension fund managers to direct business to brokers to obtain additional services. The Myners Report recommended that brokerage costs for UK pension funds be paid by the asset manager from its management fee. In the Consultation Paper, the FSA has decided not to follow Myners' suggestion but to regulate commissions more broadly and impose new requirements for both the pension market and the retail funds market. Currently, the FSA provides different regulatory treatment to "bundled services" and "soft commissions." Bundled services refer to an arrangement whereby a broker receives cash commissions from the fund manager at an agreed rate on a transaction by transaction basis. In return, the broker supplies the manager with a package that includes both trade execution and other services, such as the provision of research materials or access to the broker's own investment analysts. With respect to soft commissions, a broker agrees to pay for certain goods and services that are supplied directly to the fund manager (usually by a third party) in exchange for the fund manager directing a specified volume of business to the broker. Under the current regulatory regime, there are specific rules regulating soft commissions, including requirements to obtain prior customer consent and for periodic disclosure of commissions paid and value of services received. The FSA rules, however, do not address specifically bundled brokerage arrangements. The FSA is proposing to eliminate this regulatory distinction between soft commissions and bundled services. The Consultation Paper proposes two main regulatory changes. First, the FSA is proposing to prohibit the purchase with commissions of goods and services for which there is reasonably predictable demand. These types of goods and services would include market pricing and information services, custody services, computer hardware and dedicated telephone lines, and the payment of fees for seminars and publications. 1 A copy of the Consultation Paper is available at, <http://www.fsa.gov.uk/pubs/cp/cp176.pdf>. 2 Second, the FSA is proposing that where a fund manager buys other services in addition to trade execution (e.g., research or access to the broker's analysts) with commissions, it must determine the cost of those services and rebate that amount to the fund. The effect of this proposal would be to limit the automatic pass-through of commissions to trade execution costs. * * * The Consultation Paper does not contain proposed amendments to rules and guidance. The FSA plans to issue another

consultation paper later in the year after it receives comments on this consultation document. Comments on the Consultation Paper are due to the FSA by August 29, 2003. The Institute will be considering whether to submit comments on the Consultation Paper. If you have any particular concerns about the FSA's proposals, please contact me at (202) 326-5810 or at jchoi@ici.org no later than June 30, 2003. Jennifer S. Choi Associate Counsel

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