

MEMO# 18775

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UK FSA ISSUES SOFT COMMISSION PROPOSALS

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [18775] April 14, 2005 TO: INTERNATIONAL COMMITTEE No. 7-05 RE: UK FSA ISSUES SOFT COMMISSION PROPOSALS The UK's Financial Services Authority (FSA) recently proposed rules for bundled brokerage and soft commission arrangements. A copy of the consultation paper is available at, http://www.fsa.gov.uk/pubs/cp/cp05_05.pdf. As you may know, the FSA first published a consultation paper on the use of soft commission and bundled brokerage arrangements in April 2003. In the consultation paper, the FSA proposed two main regulatory changes: (1) to prohibit the purchase with commissions of goods and services for which there is reasonably predictable demand and (2) to require that the fund manager determine the costs of execution and research and rebate the costs other than execution to the fund. In 2004, the FSA issued policy statements that narrow the definition of research and set out FSA views on "non-permitted" services. The FSA determined to hold off from requiring managers to rebate to clients the portion of their commission costs that do not represent costs of execution and gave industry time to devise a code to provide transparency and accountability in the use of client commissions. The FSA is now proposing rules to implement its approach to soft commission and bundled brokerage arrangements. The proposals will limit managers' use of commissions to the purchase of "execution" and research" and provide guidance on what services cannot be purchased with commissions at all. In addition, the proposals will require managers to disclose to each client the total amount of commissions paid to each broker and the manager's estimates of the amounts that represent execution and research. The FSA's proposals will work in conjunction with a disclosure code (Code) developed by the UK fund and brokerage industries. The Code requires disclosure, in a standard form (on an annual basis), of: (1) a description of investment managers' policies, processes and procedures in the management of costs paid on behalf of clients and (2) client specific information on how commissions paid have been generated and how they have been used (including a split between commissions spent on execution and research). The proposed rules provide a presumption of acceptability to the Code while allowing managers to provide other forms of disclosure in appropriate cases. Managers not following 2 the Code, however, must be able to demonstrate why they believe the level and content of the disclosure is sufficient and appropriate. The FSA's proposed rules would apply to firms authorized to carry on investment management business in the UK, regardless of the client's location. The FSA proposes to make the rules effective as of January 1, 2006 (with a 6-month transition period). According to the FSA, final rules will be published by the third quarter of 2005. The FSA will propose additional

rules for how the enhanced disclosure regime should operate to the benefit of retail fund investors by the third quarter of 2005. * * * * * Comments on the consultation paper are due to the FSA by May 31, 2005. 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 May 1, 2005. Jennifer S. Choi Associate Counsel

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