New City Initiative

TO: The Financial Conduct Authority

REFERENCE: DP14/3 – The Use of Dealing Commission regime

FROM: The New City Initiative

DATE: 10 October 2014

I am writing in my capacity as Executive Director of the New City Initiative, in response to the invitation to comment on the use of Dealing Commission regime.

New City Initiative (NCI) is a think tank on financial reform, whose membership is drawn from privately owned asset management companies across Europe. Our 51 member firms manage almost £450 billion on behalf of institutions, private clients, and retail investors. Details about NCI can be obtained from www.newcityinitiative.org.

The members of NCI all strongly believe in transparency, treating clients honestly, fairly, and straightforwardly, and welcome any moves that improve this. We support complete cost disclosure, as this would enable customers to make fair comparisons between fund charges, ensuring that fund managers exercise tight control over costs. Our industry is extremely competitive and greater transparency would inevitably force down costs over time, ensuring a better outcome for customers.

However, if MiFID II endeavours to restrict the use of dealing commissions, we believe it could have an adverse impact on the UK investment management industry – and ultimately, on investors. Rather than an outright ban on the use by fund managers of research provided by brokers and paid for through broking commissions, we would suggest instead a simple breakdown of these costs, and their inclusion in the Annual Management Charge (or the old Total Expense Ratio).

This would permit clients to decide whether such costs are beneficial when compared with the performance outcome or competing AMC charges levied by comparable firms.

Moreover, the outright prohibition of dealing commissions for research would create a relatively less competitive UK asset management industry. If the proposal to unbundle research from dealing commissions comes to pass, the UK (and by extension the European) investment management industry would be disadvantaged vis-à-vis US and Asian competition, where research can still be paid for with dealing commissions. There is no indication that either the Asian or US regulators will follow suit on banning dealing commission paid-for research.

Furthermore there is risk of confusion and unhelpful complication: how will a UK/EU-based fund management firm compel a non-UK/EU broking firm to strip out commission paid-for research?

To ban dealing commission paid-for research will create higher barriers to entry for new firms. Smaller asset managers and start-up firms will be disadvantaged, as they are less able to defray the fixed costs of both external and internal research, compared to their bigger competitors. Their access to research *per se* may be curtailed, which may disadvantage clients. Yet large firms may still receive research ‘for free’, as they generate such large execution-only commissions; brokers may build an implicit marginal subsidy for research into their commission rates. This would not technically breach regulations but small firms, who would be more explicitly required by brokers to pay for research, would be disadvantaged.

These are the fundamental flaws of the proposed new regulation as we see it. There are others. Various terms used – such as “minor non-monetary benefits”, “valued-added research”, and “widely disseminated, generic research”, are highly subjective and open to interpretation. The DP14/3 paper focuses solely on dealing commission for equities, allowing multi-asset firms to use the fixed-income research (for example) to cross-subsidise the research for equities – again, to the disadvantage of those firms that have a single focus on equities. Larger firms may well be able to ‘lock-up’ broker resources and key research, squeezing smaller boutique firms out of obtaining that same information.

It is not sufficient to criticise a proposal however, without making some positive suggestions. NCI is a firm believer in transparency; instead of an outright ban on dealing commissions we would encourage the introduction of rules specifying how much broker-provided research is provided, and how much it costs fund management firms. Currently, investment managers are required to disclose the level of dealing commissions charged to a Fund, and the nature of the research received in return for this cost, *only* in the financial statements of the Fund. This is insufficient; we would like to see it become a requirement that dealing commissions should be included in the ongoing charges' figure of a Fund, so that investors can clearly identify the *total costs* charged against their investment, in any one year. We would also like to see investment managers disclose the level of dealing commissions incurred, as a percentage of the assets under management, in the Key Investor Information Document (KIID). We recommend that a detailed breakdown of the research costs is included in the KIID, showing the largest 10 suppliers and the nature of the research received.

If this enhanced level of reporting was introduced, investors would be able to make more informed decisions about their choice of investment funds, and the costs of managing those funds. Managers would also become more judicious about controlling the costs of research charged to client money. By including dealing commissions in the Ongoing Charges Figure, we are convinced that investment managers would control research costs more effectively – and, crucially, the client would also be able to make a cost/benefit analysis for each Fund, which currently is an almost impossible task.

In sum we recommend:

A: Transparency of research commission payments rather than outright prohibitions.

B: Dealing commissions to be included in Annual Management Charges, historically termed the Total Expense Ratio.

C: Flexibility when dealing with non-EU/UK brokers, where unbundling is not possible.

We would be delighted to engage further with you on these matters and look forward to communicating with the FCA on dealing commissions in the future.

With best wishes

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