

MiFID Coordination  
Markets Policy and International Division  
Financial Conduct Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

Sent by email cp16-29@fca.org.uk

21 December 2016

Dear Sirs,

**Re: Public consultation by the FCA on Markets in Financial Instruments Directive II  
Implementation – Consultation Paper III CP16/29**

I am writing on behalf of Euro IRP, the trade association which represents Europe's independent research providers in response to your request for comments on your current consultation on the funding of research.

We would like to thank the FCA for inviting Euro IRP to a consultation meeting at the FCA offices on December 13<sup>th</sup> as part of this process.

Euro IRP has taken a keen interest in the development of MiFID II rules on investment research and has worked directly with the European commission, ESMA and the UK regulator in order to help ensure that the rules as implemented work to improve the efficiency and rectitude of the market for research to the ultimate benefit of the beneficial owners of financial assets and of society in general.

Independent Research Providers (IRPs) across Europe pride themselves on offering investment research to our clients that is un-conflicted. By this we mean that our businesses do not offer services other than research which could potentially cause our research to be tainted, services such as investment banking, underwriting or corporate broking, proprietary trading or market making, management consultancy services for clients other than investors, or from companies that were the subject of this research.

We believe that the research market in Europe has for many years been dominated by companies whose research is potentially conflicted and that this has worked to the detriment of asset owners. The conflicts of interest embedded in the business models of many major research providers have been exacerbated by the practice of research payments being bundled together with payments for execution services. This bundling together of two disparate services has led to a false market in research, hiding the true costs of research from asset managers, artificially inflating the payments for research to the leading investment banks and so damaging the interests of asset owners.

We strongly welcome the aims of the provisions of MiFID II in relation to investment research. We see these as, inter alia, a strict unbundling of research and execution payments, clear pricing and valuation of research services consumed by the buy-side, appropriate budget controls over research payments and much improved transparency of payments to research providers.

We believe these aims, if appropriately implemented, will lead to:

- the creation of a much more competitive research market
- high quality research from a wide range of sources being appropriately rewarded
- poor quality research being competed away
- asset managers being able to identify and use quality research more effectively,
- asset managers facing fewer conflicted, and thereby potentially misleading, sources of research, and
- asset owners seeing reduced costs and improved returns.

Our view is that the guidance provided by ESMA has resulted in a delegated directive which will lead to significant improvements in the market for research.

Rather than respond to the detailed questions posed in the Consultation Paper, many of which are not relevant to Euro IRP's membership, we feel it is more appropriate to provide our broad response to the issues that are key to our members.

Firstly, we would like to state that we believe that the FCA's approach to the implementation of MiFID II in relation to investment research has been properly focussed on the interests of asset owners. The market for investment research has, for many years, been dominated by conflicts of interest which have led to significant market inefficiencies. These inefficiencies have:

- Significantly tilted the market in favour of conflicted providers of research, who have been able to cross subsidise their research offering via their investment banking and trading franchises
- Promoted a market in which unbundled research is paid via a separate process to bundled research, leading to significant price distortions
- Excessive production on "maintenance" research which has increased costs for investors and hindered asset managers attempts to identify strong investment themes
- Inadvertently encouraged fund managers in many regulatory jurisdictions to use client monies to pay for a range of services which could not be reasonably considered as research
- Helped prolong the fiction that "Research is free".

Secondly, we would like to praise the FCA's approach to the MiFID consultation process. We feel that the FCA has been very open-minded and responsive to submissions aiming to improve the market regime. We broadly welcome the approach taken by the FCA in response to the MiFID II proposals and believe that the approach taken will allow fund managers to use research from, and appropriately remunerate, a much wider range of research providers.

Thirdly, would ask that the FCA works with the European authorities to bring greater clarity to the treatment of fixed income (FI) research. While welcoming the fact that the MiFID regime will be applied to all forms of research, we believe that the market is currently confused as to how to transition to a paid model for sell-side FI research that is currently bundled. Fixed Income research service charges from investment banks/brokers are currently hidden inside the spread. Market participants are confused as to how costs should be explicitly identified and remunerated. A number of IRPs currently charge explicitly for FI research and so a market price is discoverable. However, as long as the market is predominantly serviced via a non-priced mechanism, market distortions will remain.

Fourthly, we welcome the FCA's explicit re-iteration that Corporate Access is NOT a research service provided by the sell-side. While meetings with corporate executives are viewed by many buy-side firms as extremely valuable elements of their investment process, investment banks/brokers should not be remunerated for facilitating such access.

Finally, we wish to state that we welcome the fact the FCA has decided that all collective investment funds should be included in the UK regulatory response to MiFID II from inception. We would encourage all regulators to adopt a similar approach, allowing a pan-European market to develop. This would reduce complexity and help produce the level playing field that the regulation intends to achieve.

There were also a couple of specific issues discussed in our consultation meeting on December 13<sup>th</sup> and we would like to take the opportunity to comment on these.

Euro IRP welcomes the FCA's intention to strengthen the language around trial periods so that investment banks/brokers (in particular) do not use free trials over an extended period as an inducement. We also recognise that asset managers require a reasonable period of time to trial research but that this cannot be used merely as an excuse not to pay for extended periods.

With regard to the research vote (previously known as the broker vote), Euro IRP understands that the FCA intend to restrict any voting within fund managers solely to adjust payments in the future and that they cannot be backward looking. While we appreciate the rationale behind this position we ask the FCA to consider the impact of such a change on the quarter's revenue (while the change takes place) that could be lost by research providers as asset managers pay forward rather than backwards. We would also like to repeat our assertion that research is a service and not a product and that it should be valued, priced and paid for accordingly. Voting can and is a useful part of that process.

We also discussed possible changes by HMRC to the charging of VAT on research and particularly on research paid for via CSA into an RPA. Euro IRP would welcome any changes to VAT that would help level the playing field for our members in order to compete equally with investment banks/brokers. We would like the FCA to take this into account during their upcoming meetings with HMRC.

Finally, we welcome the work of the FCA in addressing broader conflicts of interest within investment banks/brokers including amending the current IPO process and its relationship with research payments. Indeed, one of the concerns of our members is that there is not enough teeth in current MiFID regulation to ensure that investment banks/brokers do not find new ways of maintaining their unfair advantage in the research market. We hope that the FCA and ESMA will find ways of ensuring all market participants abide by the letter and the spirit of regulation.

We will of course be available for any questions arising.

Yours sincerely,



**Chris Deavin, Chairman**  
**The European Association of Independent Research Providers Limited**