

Back to the (bundled research) future

FCA final rules for amendments to the MiFID2 research payment rules

The FCA's new rules, permitting UK investment managers to pay for investment research through "joint" payments for research and execution services, came into effect on 1 August 2024. UK investment managers are now permitted to pay for research using these "joint" payments, as a new payment option alongside the existing RPA and P&L models.

This new option represents a significant reversal of the mandatory unbundling requirement, which many will remember was one of the headline regulatory changes under MiFID2 in 2018. This is an important option for asset managers who wish to return to a commission sharing / soft dollar model for research. However, the devil is in the detail, and it may be that some of the mandatory "guardrails" imposed by the FCA make this a less compelling option for firms than might be hoped at first glance – although the FCA has softened certain of the guardrails, compared to the April 2024 consultation.

This note sets out a summary of the final rules, and how they impact UK firms which purchase and consume investment research.

1. What's the background to the new rules?

Under the MiFID2 inducements rules, investment managers and investment advisers are prohibited from receiving benefits from third parties, including third party investment research.

This inducements ban does not apply to either: (i) benefits which fall within an expressly defined list of acceptable minor non-monetary benefits (**AMNMBs**) or (ii) third party research which is received in accordance with the permitted mechanisms for receiving research.

Under MiFID2, the only permitted routes to receive research were either:

- **P&L:** where the investment firm pays for the research from its own resources or
- **RPA:** the firm's client pays for the research through a research payment account which is operated in compliance with detailed technical requirements. The RPA may be funded either by a separate research charge paid by the client to the manager directly, or by the trade-by-trade collection of a research charge alongside the dealing commission.

MiFID2 reversed the prior regime under MiFID1, which permitted firms to receive research on a bundled basis or using soft dollars / soft commission.

On 10 April 2024, the FCA published a consultation paper ([CP24/7](#)) on *Payment Optionality for Investment Research*. The FCA proposed that UK firms should be permitted to pay for research using joint payments, as a new third option alongside the existing RPA and P&L models. **On 26 July 2024, the FCA published its policy statement ([PS24/9](#)) with the final rules, which came into force on 1 August 2024.**

2. What's the context to the FCA's new rules?

The MiFID2 research unbundling requirements were widely criticised in the market, as the RPA is seen as unduly complex to operate, and the P&L model may penalise smaller firms which are less able to afford third party research.

The unbundling requirements also impede the ability of UK firms to obtain research from US broker-dealers (which are not permitted to receive hard dollar payments for research, following the expiry in July 2023 of the SEC no-action letter, which had permitted such hard dollar payments for a transitional period after MiFID2 came into force).

Consequently, the UK government undertook to review the rules as part of the Edinburgh Reforms. July 2023's UK Investment Research Report recommended (amongst other things) that UK asset managers should be permitted to pay for research on a bundled basis. The purpose of the FCA's new rules is to give effect to that specific recommendation.

It may be helpful to provide a brief summary of the general operation of this model.

- **Bundled research:** in a bundled research model, an investment manager agrees with an executing broker to execute trades (typically in relation to equity instruments) for a higher commission rate than would otherwise be charged by the broker only for the execution of the trade. The additional commission element is then effectively used to pay for research that the investment manager has received from that broker, but *without* making a separate / unbundled cash payment to the broker (known as **hard dollars**).
- **Commission sharing agreement (CSA):** a CSA is a framework agreement between an investment manager (or its clients) and an executing broker or prime broker, under which trades are effected at an agreed, increased commission rate with the broker. This commission rate includes both an element for the costs of executing the trade, and also an additional commission element which is then allocated into a soft commission pool. The investment manager may direct the broker to pay either the executing broker or certain third party suppliers from this commission pool, using the surplus commission not allocated to the broker operating the commission pool. This similarly facilitates paying research providers with soft dollars, not hard dollars.

In the new rules (and related commentary in the policy statement), the FCA specifically refers to the new UK model as **joint payments**. The FCA explains that it does not wish to use the terminology of either "bundled research" or "commission sharing", because neither necessarily correctly reflects the new guardrails. However, in practice, the FCA acknowledges that this is more akin to commission sharing than fully bundled research.

3. What does the FCA policy statement introduce?

The FCA has introduced a new option in COBS 2.3B, to allow firms to pay for research using joint payments for research and execution services, without breaching the inducements rules. The joint payments model will be subject to new mandatory "guardrails" – see section 4 of this note below, for more details.

This new joint payments option will exist alongside the existing RPA and P&L models (in other words, it will be permitted to retain the MiFID2 unbundled models, if preferred).

The existing AMNMB exemptions will also remain in place (subject to the amendments described below). As such, firms can continue to receive research for free, so long as the relevant research falls within a category of AMNMB.

4. What are the guardrails for using the joint payment model?

There will be eight new mandatory requirements associated with the use of the new joint payments model. In summary, a firm using joint payments will need:

	Requirement	Detail of requirement
1	A formal policy describing the firm's approach to joint payments	This describes the firm's approach to joint payments, and specifies how the firm's controls around joint payments operate (and operate separately from trade execution).
2	Arrangements with research providers	These arrangements must cover the methodology for calculating and identifying the cost of research. <i>(This doesn't need to be a separate agreement as initially proposed by the FCA.)</i>
3	A structure for the allocation of payments between research providers	This includes payment allocations to both executing brokers and independent research providers. This will allow for alignment with the CSA payment structure which is typical in the US.
4	Operational procedures for the administration of accounts used to purchase research	This includes reconciliation and reporting, and to ensure timely payments to providers. The FCA notes that, unlike the RPA model, there is no requirement for monies to be swept into a bank account belonging to the investment manager.
5	A budget to establish the amount needed for third party research	This budget must be reviewed and renewed at least annually. The budget must be based on the expected amounts needed to purchase research (as opposed to volumes or values of trade executions). The budget must be set at appropriate aggregated levels for a firm's investment process, products, services, and clients In addition, the firm's policy must set out what actions to take if the research charges exceed the budget (e.g. a disclosure as soon as reasonably practicable), or the budget is increased.
6	An approach for the allocation across clients of the costs of research purchased through joint payments	The relative costs incurred by clients must be commensurate with the relative benefits received. However, the specific costs of individual items need not be attributable to individual clients.
7	An annual assessment of value	The firm must periodically assess the value, quality and use of research purchased using joint payments. The firm must ensure research charges to clients are reasonable. One way of doing this is to benchmark prices paid for joint research against relevant comparators.

8	Client disclosures	<p>These must cover:</p> <ul style="list-style-type: none"> • the use of joint payments • the key features of the firm’s approach to implementing the joint payment option • if and how joint payments are combined with any other payment option • the expected annual costs (as part of ex-ante costs and charges disclosure) • the types of research providers (<i>this requirement has been softened from the CP which required disclosure of the most significant research providers</i>) • the costs incurred (<i>but not actual amounts paid to research providers</i>) <p>In a contrast to the RPA rules, there is no regulatory requirement for client consent. There may however be contractual requirements or existing operational reasons why client consent is necessary in practice.</p>
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In addition, best execution rules remain in place. In particular, research services must not be a factor in assessing best execution.

5. Which firms will be affected by these changes?

The changes will impact UK FCA-authorized MiFID firms, which are subject to the inducement rules in FCA COBS 2.3A and the research payment rules in COBS 2.3B.

Given that there is a very wide AMNMB exemption for FICC research, in practice these changes may be more relevant to UK firms with equities strategies. (In other words, because it is permissible to receive FICC research for free in the UK, there may be less need in practice to implement a joint model).

The FCA has said that it will separately consult on how the changes can be mapped across to UK AIFMs and UK UCITS Mancos, under the equivalent rules in COBS 18. It appears that the FCA’s intention is that the changes being made to the MiFID regime should also be made to the fund management regime. However, this has not yet happened as at 1 August.

Non-UK investment managers will not be impacted by these changes. Although this will amend UK MiFID, EU MiFID firms subject to EU MiFID are not impacted.

6. Are there other changes?

Yes, two further changes have been made:

- The FCA added to the list of AMNMBs a new express exemption, which confirms that short-term trading commentary is an AMNMB. As such, short-term trading commentary may be received by a UK firm for free, without breaching the inducements rules.
- Separately, the FCA also deleted the existing AMNMB relating to research on companies with a market capitalisation of less than GBP 200 million, on the basis that the new option for joint payments can apply to research on companies of any size and to avoid any additional complexity in the rules. (The equivalent AMNMB exemption relating to corporate access for such issuers remains in place).

7. What will be the options for receiving research?

UK investment managers now have the following options for acquiring investment research:

AMNMBs	P&L model	RPA model	joint payments model <i>[NEW]</i>
<p>A firm may receive any of the following for free, as an AMNMB:</p> <ul style="list-style-type: none"> • Generic information • Issuer-sponsored research • Research received during a trial period • Research related to fixed income, currency or commodity (FICC) instruments • Research from an independent research provider that is not part of a financial services group • Openly available / publicly available research • Short-term trading commentary, linked to trade execution services <i>[NEW]</i> 	<p>Separately from the AMNMB exemptions, a firm may receive research in return for direct payments by the firm out of its own resources (P&L).</p>	<p>Separately from the AMNMB exemptions, a firm may receive research in return for payments from a separate RPA, provided that:</p> <ul style="list-style-type: none"> • the RPA is funded by a specific research charge to the client • the manager must set and regularly assess a research budget as an internal measure • the manager must regularly assess the quality of the research purchased • the manager makes prior, ongoing and ad-hoc disclosure of the use of the RPA • the manager obtains and documents the client's agreement to use of the RPA • the manager complies with governance, oversight and control requirements 	<p>Separately from the AMNMB exemptions, a firm may receive research in return for bundled (joint) payments for third party research and execution services, provided that the manager implements:</p> <ul style="list-style-type: none"> • arrangements with research providers and structures for allocation of payments • a budget to establish the amount needed for third party research • an approach for the allocation across clients of the costs of research purchased through joint payments • an annual assessment of value • client disclosures

8. What's the timing?

The rules come into force on 1 August 2024.

9. What should we do, if we want to use the joint payment model?

UK MiFID firms will (if they choose to do so) be permitted to move to a joint payments model for research from 1 August. In order to do so, firms will need to comply with the conditions summarised above.

Fund managers (AIFMs or UCITS Mancos) will need to wait for the parallel rules for those firms to be published.

In particular, firms will need to focus on implementing a joint payments policy, and related internal processes. You will need to set a budget as well as related budgeting procedures. You will need to enter into (or amend) arrangements with research providers. This can include existing terms of business. On the client-facing side, you'll also need to update disclosures, and potentially terminate any existing RPA arrangements.

Simmons & Simmons would be pleased to discuss this further with you.

10. What does Simmons & Simmons think?

It makes for great headlines to say that the FCA is reversing the little-loved MiFID2 research rules. Certainly, it's a net positive for the asset management industry for the FCA to reintroduce the option of allowing joint payments for research. It removes a competitive disadvantage for UK firms, and allows global groups (and particularly US-headquartered alternative firms) to apply a more consistent research-purchase model.

However, more than half a decade after MiFID2 came into force, firms may be excused for feeling that these changes are too little, too late. While the changes do at face value reinstate joint research, there are prescriptive conditions associated with the use of the model. Some requirements have been softened in the final rules, for example, there is no longer a requirement to have a separate written agreement with research providers – you need arrangements in place and can use existing terms of business. Also, firms no longer have to benchmark against relevant comparators, it is included only as an example of how to ensure costs are reasonable. Firms no longer have to disclose their most significant research providers, just the types of research providers that are used. However, although the FCA professes that the joint model will be operationally easier than RPAs, there doesn't appear to be a huge substantive difference in the operational requirements.

There will no doubt be a group of firms (perhaps smaller, perhaps equities-focused) where this development is a significant win; but other firms may feel that it's more straightforward to retain the existing P&L or RPA models.

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