

March 2005

05/5 *newsletter* ★ ★



This newsletter provides a summary of CP05/5. Please see 'Who should read this paper?' below to see if CP05/5 is relevant to you.

Financial Services Authority

Bundled brokerage and soft commission arrangements: Proposed rules

Why are we issuing this Consultation Paper?

We are proposing rules relating to soft commission and bundled brokerage arrangements.

Who should read this paper?

This paper will be of interest principally to investment managers, investment banks, brokers and the providers of services such as market information services and independent research. It will be of direct interest to institutional investors such as the trustees of pension funds.

It will also be relevant to retail fund trustees and depositaries, investors in retail products and to the providers of these products – such as unit trust managers, authorised corporate directors, other investment companies (including investment trusts) and life assurance companies.

What is the background to this?

In April 2003, we published Consultation Paper 176 'Bundled brokerage and soft commission arrangements' (CP176). In that paper, we concluded that the use of soft commission and bundled brokerage arrangements resulted in incentive misalignments between investment

managers and their clients – that is, conflicts of interest. This is due to the opaque nature of the arrangements under which investment managers make direct charges to the funds they manage, by way of dealing commission, to purchase goods and services in addition to execution. The lack of transparency and accountability mechanisms in the relationship between brokers and investment managers also makes it difficult for customers to judge whether their interests are being well served by their investment manager. Consequently, this meant market controls were weak.

Subsequently, we have refined and developed our thinking on these issues and we set out our proposed policy approach in two Policy Statements: Policy Statement 04/13 ‘Bundled brokerage and soft commission arrangements: Feedback on CP176’ (PS04/13) and ‘Bundled brokerage and soft commission arrangements: Update on issues arising from PS04/13’ (PS04/23).

We are now in a position to issue proposed rules addressing our concerns with soft commission and bundled brokerage arrangements. As we explained in PS04/13 and PS04/23, the industry has also been allowed space to tackle the identified lack of transparency and accountability. It has done this through developing an industry-led solution based on an enhanced disclosure regime. We are satisfied that the industry proposals (as explained in the second and third bullet points in the answer to the next question) provide credible means of addressing these problems.

What will these proposed rules do?

Our proposed rules, together with the industry proposals, will:

- limit investment managers’ use of dealing commission to the purchase of ‘execution’ and ‘research’ services;
- require investment managers to disclose to their customers details of how these commission payments have been spent and what services have been acquired with them;
- embed in the commercial relationship between investment managers and brokers incentives to secure value for clients for execution and research spend; and
- promote a more level playing field in the production of research, whether within investment banks or by third parties.

We are confident that these measures will address the lack of transparency and associated accountability identified in CP176 and lead to improved management of conflicts of interest. They also demonstrate our intent to work, where possible, with the grain of the market in arriving at solutions to issues affecting firms and investors, particularly those in wholesale and institutional markets. Our approach of facilitating the development of an industry-led solution to a market failure is an example of successful partnership with the wholesale industry.

In the coming months, we will be working closely with the industry to develop measures to test whether the combination of our rules and the industry’s solution will deliver our outcomes.

How is this Consultation Paper set out?

In the paper, we:

- summarise our proposals in PS04/23, the tenor of responses to PS04/23 and comment on the major issues raised by these responses (see Chapter 2);
- present proposed rules and guidance to give effect to our policy objectives (see Chapter 3); and
- discuss related issues and present our next steps on this project (see Chapter 4).

What happens next?

We invite comments on the paper by 31 May 2005. Following consultation, we plan to make final rules in the third quarter of 2005.

How will these proposals affect consumers?

Investment managers of retail funds – such as unit trusts, open-ended investment companies, investment companies (including investment trusts), and life and pension funds – are commonly party to bundled brokerage and soft commission arrangements. So, consumers with interests in such funds, whether directly or through PEPs and ISAs, have an interest in the issues covered in this Consultation Paper. Also, retail customers with a direct relationship with investment managers will have an interest if their investment manager has bundled brokerage or soft commission arrangements with a third party.

This newsletter summarises Consultation Paper 05/5. The Financial Services Authority invites comments on this CP. Comments should reach us by **31 May 2005**.

Comments may be sent by electronic submission using the form on the FSA's website at (www.fsa.gov.uk/pubs/cp/cp05_5_response.html).

Alternatively, please send comments in writing to:

Paul Craig
Wholesale and Prudential Policy Division
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7066 5406

Fax: 020 7066 9734

E-mail: cp176@fsa.gov.uk

It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure.

How can I get the full paper?

You can download the full Consultation Paper from:

www.fsa.gov.uk/pages/Library/Policy/CP/2005/05_05.shtml

Or you can order hard copies of the paper:

Phone our helpline on 0845 608 2372, quoting reference CP05/5

Order online at: www.tso.co.uk/bookshop/bookstore.asp?FO=1159966&DI=510776

Copies are available at £10 each. Please allow five working days for delivery.

We also have a targeted email alert service for all FSA newsletters.

To subscribe please visit: www.fsa.gov.uk/pages/Doing/Contact/Register/index.shtml

For more information on our publications, please go to:

www.fsa.gov.uk/Pages/library/index.shtml

To get the latest information online, please visit our home page:

www.fsa.gov.uk

The Financial Services Authority 25 The North Colonnade Canary Wharf London E14 5HS
Main switchboard: 020 7066 1000 Fax: 020 7066 1099