

FCA to clamp down on misuse of equity commissions

IFR 2033 17 May to 23 May 2014 | By Christopher Spink

<http://www.ifre.com/fca-to-clamp-down-on-misuse-of-equity-commissions/21146171.article>

London-based investment banks, already suffering from weak trading in fixed income, currencies and commodities, could now also face a tougher climate in equities after a clarification by UK regulator the Financial Conduct Authority about how dealing commission can be charged.

In a policy statement the FCA said that from June 2 investment managers must only pay dealers' commission to banks for actually executing a trade and for the provision of "meaningful research" that has a "conclusive" view.

In 2006 the traditional London broking model, in which fund managers paid all-inclusive fees to banks' dealers for

carrying out trades and ancillary services was overhauled. But the structure was broadly retained as long as the services provided were specified.

One former fund manager, who had also worked on the sell-side earlier in his career, estimated that since then the total costs of an all-in service had remained at around 20bp while the costs of actually carrying out a trade had dropped from 10bp to 2bp for more liquid stocks. “That means in effect that the cost of providing research and associated services has risen from 10bp to 18bp per trade,” he said. “This explains why the FCA has felt obliged to look again at dealers’ commission.”

Part of the fall in costs has come as more trading has migrated on to dark pools and other electronic platforms provided by banks or third parties. This has also made it harder for customers to compare costs. “The fragmentation of equities trading, through dark pools, has made the process less transparent for the buy-side,” said Seb Walker, a partner at Tricumen.

In an initial speech delivered at the beginning of the consultation, FCA chief executive Martin Wheatley said a particular concern was that brokers were in effect charging significant sums – the combined figure has been put at £500m – for “corporate access” to the management of issuers, in some cases unbeknown to those executives.

The policy statement of May 8 now explicitly states that this practice in which brokers charge investors large sums for arranging meetings with an issuer's executive team can no longer continue and must be charged separately from the commission paid to execute trades, along with associated research that helps lead to such a decision. "Investors should be confident that dealing commission is only used to buy execution or research services that deliver real value," said Wheatley. "These changes offer firms a real opportunity to show they put their clients first and strengthen the industry's reputation for transparency."

Fund managers' decision?

Investors, issuers and brokers said it was unclear yet how the market would react to the clampdown. Most banks declined to comment but Christian Krohn, managing director at trade body Association for Financial Markets in Europe, said the onus was firmly on fund managers to comply. "The policy statement has some helpful clarifications, including that it is the investment manager's responsibility to assess whether or not a service can be paid out of dealers' commission," he said.

The existing model might not change as rapidly as some predict, since research could still be mingled with other broking services, in addition to executing trades, providing those other items were paid separately from commissions. "Lots of funds like the service the banks provide and they

won't stop doing it," said Matt Johnson, investor relations director at FTSE 100 builders' merchant Travis Perkins. "Some shareholders call us direct. Others will go through brokers."

Putting a price on research and other services, unbundled from execution, may also prove problematic for both the buy and sell side. Some idea could be gleaned from prices charged by independent research houses and other third-party providers, such as corporate access arranger Ingage IR. "The FCA's publication will effectively put an end to bundling research and corporate access charges together," said Michael Hufton, managing director of Ingage. "These regulatory changes should enable the quality and focus of equity research offerings to increase."

The FCA has estimated that investors are charged £3bn a year in dealers' commissions. If that is halved then London-based banks could face a severe drop in revenues, unless they can persuade investors to pay for access to management through different methods.

The regulator's statement also warns that the whole "antiquated" system, whereby the service provider controls pricing, could be radically overhauled as part of wider European regulations under the latest market in financial instruments directive (MIFID II), due to take effect in 2016. "We are clearly at a high point in terms of change here. Banks have previously had it all their way. But we are not

going to see major change overnight,” said Rupert Welchman, fund manager at UBP.

International Financing Review (IFR) is the world's leading source of capital markets intelligence, and has been for nearly 40 years. Published weekly, it provides senior investment banking decision-makers with authoritative and unbiased commentary and analysis.



THOMSON REUTERS