Source: Financial Times

FCA proposes to reverse Mifid rules on investment research

UK regulator says asset managers should be able to pay for ‘bundled’ research and trading fees

Nikou Asgari and Emma Dunkley in London, 10 April 2024

Asset managers should be able to pay for their investment research alongside fees for trading, the UK market regulator has proposed, reversing a long-standing policy in an effort to energise the UK’s capital markets.

The Financial Conduct Authority on Wednesday said fund managers should be able to “bundle” fees for investment bank research with their trading costs after a review of the controversial practice.

Its proposal would row back on an important plank of Mifid II, the EU’s post-2008 financial reforms package, and spearheaded by London’s politicians and regulators.

Although the rules were intended to clamp down on conflicts of interest and boost more independent coverage, they led to even less coverage of small and medium-sized stocks. After the UK left the EU, some politicians and Westminster think-tanks encouraged the UK to ditch the rules. EU officials are also rolling back their investment research rules.

Last year, UK chancellor Jeremy Hunt said he would encourage more research on small and medium-sized companies and entice more businesses to list in London.

“It is ironic that this is probably going to be positioned as a post-Brexit freedom but we were the ones that pushed this on to the Europeans, we drove this,” said Mike Carrodus, founder of Substantive Research, an investment research analytics company.

He added that changing the rules alone was unlikely to boost research on new asset classes or companies. “None of this is going to happen without demand coming from the end investor in new areas . . . which then requires external research to service those assets.”

Steven Fine, chief executive of Peel Hunt, told the Financial Times that the move was “one of a series of measures necessary to reinvigorate UK markets”.

Mifid II rules came into force in 2018 and led to the separation of fees charged by investment banks to asset management clients for trading execution and research.

However, this “unbundling” often left asset managers paying upfront for the cost of research, putting greater pressure on smaller companies in particular.

“There’s a degree of ‘the horse has already bolted’,” said Barry Norris, an equity fund manager at investment boutique Argonaut Capital, adding that “the quality of broker research is also a lot worse now than it used to be. The other thing is that the banks, having dropped their prices for dealing, will now struggle to put them back up even if it does include research.”

Under the proposals, asset managers would be able to choose whether to pay for research separately, or together with other trade services.

The FCA said the move would give fund managers “greater freedom in how they pay for research, supporting their investment decisions”, and bring the UK more in line with EU and US rules on paying for investment research.

A chief executive in the industry said: “Smaller asset managers are having a tough time and are more likely to bundle and pass on costs to end investors.”

He added that the FCA was “trying to ensure there’s plenty of research produced for small UK companies”, noting that fees for research on small-cap stocks were generally low.

Independent brokers — especially those that trade small-cap stocks — have felt the heat, as Mifid II made it harder for them to compete with the larger investment banks. Many smaller brokers have been forced to cull their research teams or merge with rivals.