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Adam Wreglesworth
Wholesale Conduct Policy & Client Assets
Markets Division
Financial Conduct Authority
25 The North Colonnade
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London E14 5HS

Submitted via cp13-17@fca.org.uk

Re: **CP 13/17 Consultation on the use of dealing commission rules**

Dear Sir/Madam:

Markit¹ is pleased to submit the following comments to the Financial Conduct Authority (the “**FCA**”) in relation to its Consultation Paper *Consultation on the use of dealing commission rules* (the “**Consultation Paper**” or the “**CP**”).²

Markit is a provider of financial information services to the global financial markets, offering independent data, valuations, risk analytics, and related services across regions, asset classes and financial instruments. Our products and services are used by a large number of market participants to reduce risk, increase transparency, and improve the operational efficiency in their financial markets activities. In the context of the FCA’s Consultation Paper the Markit Commission Manager and the Markit Vote products seem directly relevant.

Markit has been actively and constructively engaged in the discussion regarding regulatory reform of the financial markets.³ Over the last several years, we have

¹Markit is a financial information services company with over 3,000 employees in Europe, North America, and Asia Pacific. In addition to other services, the company provides independent data and valuations for financial products across all asset classes in order to reduce risk and improve operational efficiency. Please see www.markit.com for additional information.

² FCA Consultation Paper 13/17: Consultation on the use of dealing commission rules. November 2013.

³ We regularly provide regulatory authorities with our insights on current market practice, for example in relation to valuation methodologies, liquidity measurement, the use of reliable and secure means to provide daily marks, or pre-trade credit checks to achieve clearing certainty. We have also advised

submitted over 90 comment letters to regulatory authorities around the world and participated in numerous stakeholder meetings.

Introduction

We welcome the publication of the FCA's Consultation Paper and we appreciate the opportunity to provide you with our comments. Our below views are mostly based on the experiences that we have gathered over the years by offering the following services that seem directly relevant in the context of the FCA's Consultation:

- Markit Commission Manager:
 - o Markit Commission Manager is a web-based tool that is used by investment managers to manage the research commissions that they generated with their brokers by virtually aggregating commission credits. This solution has been available for several years and is currently used by over 100 buy-side clients and more than 25 sell-side firms in Europe, North America, and the APAC region. The reconciliation engine and detailed matching criteria that are embedded in the platform help streamline the reconciliation process and increase operational efficiency by allowing customers to manage commissions via a single platform.

- Markit Vote:
 - o Markit Vote is a web-based solution that enables buy-side firms to evaluate their brokers and research providers in a comprehensive, granular, and auditable manner. The platform allows fund managers to vote across teams, asset classes, and regions. It includes an administrative interface for buy-side firms to set-up the vote based on firm-specific configurations. It also provides a set of broker scorecards and commission reports that can be generated by team and downloaded in various formats.

regulatory bodies on potential approaches to enable the timely and cost-effective implementation of newly established requirements, for example through the use of multi-layered phase-in or by providing participants with a choice of means for satisfying their regulatory obligations.

Q1: Do you agree with detail of the rule and guidance changes we have proposed?

Q2: Do you agree with the justification and cost benefit analysis for these changes?

In general, we believe that the FCA's guidance is appropriate and largely consistent with the approach that many firms have been establishing in recent years. Specifically, the FCA should note that Markit established the Commission Manager platform in response to increasing demand from buy-side firms for the virtual aggregation of commission credits to help manage their credits transparently and effectively whilst reducing the burden associated with accessing numerous platforms of individual brokers.⁴ Over the last several years we have observed significant progress in terms of client adoption and evolution of appropriate procedures at buy-side and sell-side firms, both to manage commission credits and to appropriately measure the value that is provided by sell-side research.

Specifically, many of our UK-based asset manager and hedge fund clients have adopted a more rigorous broker and research provider evaluation process as best practice. A more granular and frequent measurement of the value that asset managers receive from sell-side brokers now often contains the following elements:

- For their voting process, asset managers will now mostly differentiate by asset class, i.e. they will vote separately for equities, fixed income, and commodities, and by region;
- Many buy-side firms will also vote separately for specific functions of brokers, e.g. for research, trading and back-office, whilst some buy-side firms would even vote at the level of the individual research analyst; and
- Broker votes now mostly take place on a quarterly or semi-annual basis.

We have also observed that, as part of the workflow improvement on the buy-side, many firms have set up budget caps for research and individual services and will turn commission rates to execution-only once such budget caps have been reached. Further, buy-side firms are increasingly investing in workflow technology to better manage their broker evaluation and commission allocation process.

On that basis we have the following comments to specific aspects of the FCA's Consultation:

⁴ Markit Commission Manager enables users to reconcile their trading commission with multiple counterparts and then instructing those counterparties to pay for research and brokerage services – all from a single platform.

- The FCA proposed that, “where goods and services relate to the provision of research”, investment managers will need to have “reasonable grounds to be satisfied that they meet the requirements if the research satisfies several criteria.”⁵ In this respect, many asset managers now use tools such as Markit Vote to regularly gather comprehensive feedback from the users of research throughout their organization to be in a position to measure its quality and effectiveness. Such information, once it has been gathered in a transparent and auditable process, will then be assimilated within our tool and communicated back to the relevant sell-side firms in form of “scorecards”.
- The FCA stated that “where a substantive research good or service is provided to an investment manager within a bundle of goods and services, the fund manager should take steps to disaggregate the substantive research from the other services to ensure they use dealing commission in compliance with our rules.”⁶ The FCA further stated that firms should make “an honest and fair mixed-use assessment to distinguish the cost of any research element in line with the best interests of their customers”.⁷ Markit Commission Manager captures data around the commission allocation process and the payment of third party research in a transparent and auditable manner. As such, buy-side firms will be better equipped to discuss with their clients how and why they have decided to consume certain research services and how they have compensated their research providers. This information can help the firm to link the value that it derived from research to the performance of the fund manager on behalf of a given client.
- The FCA stated that asset managers will need to develop an internal policy on what amounts to permitted research and set a budget for paying for it.⁸ Also, brokers should have systems and controls in place to ensure that commissions are only

⁵ Specifically, it must be a) capable of adding value to the investment or trading decisions by providing new insight that inform the investment manager when making such decisions about its customers’ portfolios, b) whatever form its output takes, represents original thought, in the critical and careful consideration and assessment of new and existing facts, and does not merely repeat or repackage what has been presented before, c) it has intellectual rigour and does not merely state what is commonplace or self-evident, and d) it involves analysis or manipulation of data to reach meaningful conclusion. FCA Consultation Paper 13/17, Section 2.10.

⁶ FCA Consultation Paper 13/17, Section 2.35.

⁷ FCA Consultation Paper 13/17, Section 2.30.

⁸ “If this additional clarity does reduce non-compliance, more investment managers will ensure they only pay for goods and services out of dealing commission within the scope of the permitted exceptions, while paying for other services, such as corporate access, by other means. Rigorous mixed-use assessments, which identify and ascribe a fair cost or value to any research element where it is bundled with other goods or services, should reduce the occurrence of excessive payments for bundled services with only notional research content.” FCA Consultation Paper 13/17, Section 2.37.

used to pay for permitted research.⁹ Markit's suite of tools supports fund managers in tracking and evaluating their consumption of research services, while also allowing them to track how their dealing commissions are split between research and execution. Furthermore, our services provide fund managers with the information they require to have meaningful discussions with their research and execution providers, as well as with their clients about services consumed vis-à-vis their performance. Finally, our product suite supports the unbundling process by providing not only the administrative tools necessary but also a framework that supports the fund manager throughout the process.

That said, we encourage the FCA to take into account the significant progress that the industry has made towards achieving many of the objectives that the FCA highlights in its Consultation Paper. We therefore recommend for the FCA to focus its efforts on the several, specific areas where it believes that further change is needed. This would be a much more appropriate approach than initiating a fundamental review of the Dealing Commission regime, particularly because of the unpredictable impact that such fundamental changes might have on market structure.¹⁰ We commend the IMA for its work evaluating the potential impact of a more fundamental reform, e.g. a ban on the use of dealing commission, on the competitiveness of the UK financial services sector in the global context.¹¹ We share the view that any more fundamental reform to the Dealing Commission regime should only be considered if it was implemented globally.

Q3: Do you believe there are likely to be any material, incremental costs or benefits which we have not considered here?

It can be expected that many asset managers would face increased costs to comply with the FCA proposal, specifically in order to determine whether the research they pay for via CSAs does indeed meet the FCA's requirements.

However, the FCA should note that, to the extent that asset managers considered the use of Markit Commission Manager appropriate to help them with compliance, the use of this tool is free for buy-side firms. The tool enables asset managers and hedge funds to virtually aggregate CSA balances, to match and reconcile CSA trades and to direct

⁹ Investment managers should be more thorough when negotiating the cost of meetings; clarify the capacity in which a broker is acting; and gain access to corporates even if they have lower portfolio turnover and make more 'buy and hold' investments. FCA Consultation Paper 13/17, Section 2.38.

¹⁰ Specifically, such change could easily lead not to increased but to reduced competition between asset managers, as only those firms that have larger resources available to them would continue to benefit from receiving the highest quality research and broker coverage. The smaller ones with more limited resources would only be able to access lower quality or a smaller number of research providers. We believe that this would go against the FCA's objective of fostering competition in the sector.

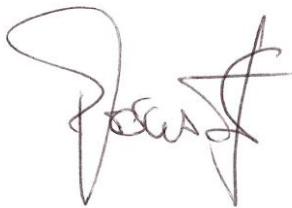
¹¹ Investment Management Association: "The Use of Dealing commission for the Purchase of Investment Research." February 2014.

CSA research payments from a single web-based platform. The Markit Commission Manager solution also enables the buy-side to generate a suite of commission reports based on balances accrued and third party payments directed through the system.

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Markit appreciates the opportunity to provide the FCA with comments on its Consultation Paper on the use of dealing commission rules. We would be happy to elaborate or further discuss any of the points addressed above. In the event you may have any questions, please do not hesitate to contact us.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'M. Schuler', with a stylized flourish extending to the right.

Marcus Schuler
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