

Chapter 2

Conduct of business obligations

2.3B Inducements and research

Application

- 2.3B.1** **R** This section applies to a *firm* carrying on *MiFID*, *equivalent third country* or *optional exemption business*.
- 2.3B.2** **G**
- (1) A *firm* providing *independent advice*, *restricted advice* or *portfolio management services* to *retail clients* in the *United Kingdom*, or which provides *independent advice* or *portfolio management services* to *retail clients* outside the *United Kingdom* or to *professional clients* is prohibited from receiving inducements (other than acceptable minor non-monetary benefits) in relation to those services under ■ COBS 2.3A.15R and ■ COBS 2.3A.16R. Compliance with ■ COBS 2.3B allows such a *firm* to receive third party *research* without breaching that prohibition.
 - (2) In addition, ■ COBS 2.3B enables *investment firms* other than those in (1) to receive *research* without subjecting it to an assessment under the inducements rule in ■ COBS 2.3A, as *research* acquired in accordance with this section will not constitute an inducement.

Receiving third party research without it constituting an inducement

- 2.3B.3** **R** Third party *research* that is received by a *firm* providing *investment services* or *ancillary services* to *clients* will not be an inducement under ■ COBS 2.3A.5R, ■ COBS 2.3A.15R or ■ COBS 2.3A.16R if it is received in return for either of the following:
- (1) direct payments by the *firm* out of its own resources; or
 - (2) payments from a separate *research* payment account controlled by the *firm*, provided that the *firm* meets the requirements in ■ COBS 2.3B.4R relating to the operation of the account.

[Note: article 13(1)(a) and (b)(excl. (i) – (iv)) of the *MiFID Delegated Directive*]

Conditions relating to the operation of the research payment account

- 2.3B.4** **R** The requirements referred to in ■ COBS 2.3B.3R(2) for the operation of a *research* payment account are:

- (1) the *research* payment account must only be funded by a specific *research* charge to *clients*, which must:
 - (a) only be based on a *research* budget set by the *firm* for the purpose of establishing the amount needed for third party *research* in respect of *investment services* rendered to its *clients*; and
 - (b) not be linked to the volume or value of transactions executed on behalf of *clients*;
- (2) (a) the *firm* must set and regularly assess a *research* budget as an internal administrative measure as part of establishing a *research* payment account and agreeing the *research* charge with its *clients*; and
 - (b) the *research* budget must comply with ■ COBS 2.3B.7R, ■ COBS 2.3B.8R(2) and ■ COBS 2.3B.11R;
- (3) the *firm* must be fully responsible for the *research* payment account; and
- (4) the *firm* must regularly assess the quality of the *research* purchased, based on robust quality criteria, and its ability to contribute to better investment decisions for the *clients* who pay the *research* charge.

[Note: article 13(1)(b)(i-iv) and (2)(a) and (b) of the *MiFID Delegated Directive*]

2.3B.5

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A *firm* using a *research* payment account must provide the following information to *clients*:

- (1) before the provision of an *investment service* or *ancillary service* to *clients*, information about the budgeted amount for *research* and the amount of the estimated *research* charge for each of them; and
- (2) annual information on the total costs that each of them has incurred for third party *research*.

[Note: article 13(1) second subparagraph of the *MiFID Delegated Directive*]

2.3B.6

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In accordance with *Principle 7* (communications with clients), a *firm* should inform *clients* in the annual information in ■ COBS 2.3B.5R(2) that they are entitled to request the information set out in ■ COBS 2.3B.20R(1).

2.3B.7

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A *firm* must ensure that:

- (1) the total amount of *research* charges collected from *clients* under ■ COBS 2.3B.4R(1) does not exceed the *research* budget established under ■ COBS 2.3B.4R(2) (and, where relevant, amended under ■ COBS 2.3B.8R(2)); and
- (2) the *research* budget and *research* payment account are not used to fund *research* generated internally by the *firm* itself.

[Note: article 13(4) and (6) of the *MiFID Delegated Directive*]

- 2.3B.8** **R** (1) A *firm* must agree with *clients*, in the *firm's* investment management agreement or general terms of business:
- (a) the *research* charge as budgeted by the *firm*; and
 - (b) the frequency with which the specific *research* charge will be deducted from the resources of the *client* over the year.
- (2) A *firm* must not increase its *research* budget unless it has provided, in advance, clear information to relevant *clients* about such intended increases.
- (3) If there is a surplus in a *research* payment account at the end of a period, the *firm* must have a process to:
- (a) rebate those funds to relevant *clients*; or
 - (b) offset it against the *research* budget and charge for relevant *clients* calculated for the following period.
- [Note: article 13(5) of the *MiFID Delegated Directive*]
- (4) In calculating a rebate or offset as set out in (3), a *firm* must take reasonable steps to maintain a fair allocation of costs between *clients*.

2.3B.9 **G** Information on increases in the *research* budget under **■ COBS 2.3B.8R(2)** should be provided to relevant *clients* in good time before such increases are to take effect.

2.3B.10 **G** A *firm* that operates arrangements for collecting *research* charges by deducting charges from those *clients'* resources should ensure that those arrangements comply with **■ CASS 8 (Mandates)**, as applicable.

Governance and oversight of research payment accounts

- 2.3B.11** **R** For the purposes of **■ COBS 2.3B.4R(2)**, a *firm* must ensure that:
- (1) the *research* budget is managed solely by the *firm* and is based on a reasonable assessment of the need for third party *research*;
 - (2) the allocation of the *research* budget to purchase third party *research* is subject to appropriate controls and *senior management* oversight to ensure it is managed and used in the best interests of the *firm's* *clients*; and
 - (3) the controls under (2) include a clear audit trail of:
 - (a) payments made to *research* providers; and
 - (b) how the amounts paid were determined with reference to:
 - (i) the quality criteria required by **■ COBS 2.3B.4R(4)**; and
 - (ii) the *firm's* policy for using third party *research* established under **■ COBS 2.3B.12R**.

[Note: article 13(6) of the *MiFID Delegated Directive*]

- 2.3B.12** **R** (1) A *firm* using a *research* payment account must establish a written policy that sets out how the *firm* will:
- (a) comply with all elements of **■ COBS 2.3B.4R(4)**; and
 - (b) address the extent to which *research* purchased through the *research* payment account may benefit *clients'* portfolios, including, where relevant, by taking into account investment strategies applicable to various types of portfolios, and the approach the *firm* will take to allocate such costs fairly to the various *clients'* portfolios.
- (2) A *firm* must provide the policy established under (1) to their *clients*.

[Note: article 13(8) of the *MiFID Delegated Directive*]

- 2.3B.13** **G** A *firm* should retain control over the overall spending for *research*, the collection of *client* *research* charges and the determination of payments.

[Note: recital (28) to the *MiFID Delegated Directive*]

- 2.3B.14** **G** In setting a budget under **■ COBS 2.3B.4R(2)**, and in light of the obligation to fairly allocate costs under **■ COBS 2.3B.12R(1)(b)**, a *firm* may wish to consider setting a budget for a group of *clients* who would benefit from the same *research*, for example because they have portfolios that are managed according to similar investment strategies. It may be appropriate to operate a dedicated *research* payment account for such a group.

- 2.3B.15** **G** Where a *firm* charges a *client* under **■ COBS 2.3B.4R(1)**, that charge should be for an amount of *money* owed to the *firm*. Therefore, provided it is collected by the *firm* only when that charge becomes due and payable, that *money* will not be *client* *money* held by the *firm* for the *client* who owed that charge (see **■ CASS 7.11.25R**).

Other operational arrangements for research payment accounts

- 2.3B.16** **R** If a *firm* uses an operational arrangement for the collection of the charge under **■ COBS 2.3B.4R(1)** where that charge is not collected separately but alongside a transaction *commission*, the *firm* must still indicate a separately identifiable *research* charge and ensure that the arrangements comply fully with the conditions in **■ COBS 2.3B.4R** and **■ COBS 2.3B.5R**.

[Note: article 13(3) of the *MiFID Delegated Directive*]

- 2.3B.17** **G** A *firm* should ensure that the cost of *research* funded by *client* charges is not:
- (1) linked to the volume or value of services or benefits that are not *research*; or
 - (2) used to cover anything other than *research*, such as charges for execution.

[Note: recital 27 to the *MiFID Delegated Directive*]

2.3B.18 **R** For the purposes of ■ COBS 2.3B.3R and ■ COBS 2.3B.4R, a *firm* may delegate the administration of the *research* payment account to a third party, provided that the arrangement facilitates payments to *research* providers, in the name of the *firm*, for the purchase of third party *research*, without any undue delay and in accordance with the *firm's* instruction.

[Note: article 13(7) of the *MiFID Delegated Directive*]

2.3B.19 **G** (1) In order that a *firm* retains sufficient control, and is responsible for, a *research* payment account when relying on a third party to administer it, the *firm* should consider whether its arrangements with that third party will ensure that:

- (a) the *firm* can collect *client research* charges relating to a specific *research* budget into a separate *research* payment account for that budget, as cleared funds, without undue delay (and, in any event, no later than 30 *days* after deduction from the *client's* account);
- (b) the *firm* retains sole, full and absolute discretion over the use of the account and the making of payments or rebates;
- (c) *research* payment account monies are ring-fenced and separately identifiable from the assets of the third party or, where the third party administrator is a *bank*, are held on deposit for the *firm*; and
- (d) the third party provider has, or its creditors on insolvency have, no right of access or recourse to the *research* payment account for its own benefit, for example to offset other fees owed by the *firm* or for use as collateral.

(2) The *firm* remains fully responsible for discharging all of its obligations to its *clients* set out in ■ COBS 2.3B regardless of any arrangements it makes with third parties, and should ensure it acts in the best interests of its *clients* when deducting *research* charges from their accounts and procuring *research*.

Disclosure on request of payments made from a research payment account

2.3B.20 **R** (1) Where a *firm* operates a *research* payment account, it must provide on request to its *clients* a summary of:

- (a) the providers paid from this account;
- (b) the total amount they were paid over a defined period;
- (c) the benefits and services received by the *firm*; and
- (d) how the total amount spent from the account compares to the budget set by the *firm* for that period, noting any rebate or carry-over if residual funds remain in the account.

(2) A *firm* must also be able to provide the information in paragraph (1) to the *FCA* on request for all *research* payment accounts.

[Note: article 13(2) of the *MiFID Delegated Directive*]

Research for the purposes of research payment accounts

- 2.3B.21** **R** A *firm* must only use monies in a *research* payment account established under ■ COBS 2.3B.3R(2) to pay for *research* or to pay a rebate to *clients* in accordance with ■ COBS 2.3B.8R(3)(a).
- 2.3B.22** **G** A *firm* should also consider whether the goods or services it is looking to receive are acceptable minor non-monetary benefits under ■ COBS 2.3A.19R or ■ COBS 2.3A.22G, which can be received without breaching the inducements *rules* under ■ COBS 2.3A.15R or ■ COBS 2.3A.16R.
- 2.3B.23** **G** Examples of goods or services that the *FCA* does not regard as *research*, and as a result could not be paid for from *research* payment accounts, include:
- (1) post-trade analytics;
 - (2) price feeds or historical price data that have not been analysed or manipulated in order to present the *firm* with meaningful conclusions;
 - (3) services relating to the valuation or performance measurement of portfolios;
 - (4) seminar fees;
 - (5) *corporate access services*;
 - (6) subscriptions for publications;
 - (7) travel, accommodation or entertainment costs;
 - (8) order and execution management systems;
 - (9) membership fees to professional associations;
 - (10) direct *money* payments; and
 - (11) administration of a *research* payment account.
- 2.3B.24** **G** A *firm* should not enter into any arrangements relating to the receipt of, and payment for, third party *research*, whether acquired in accordance with ■ COBS 2.3B.3R(1) or ■ (2), that would compromise its ability to meet its best execution obligations as applicable under ■ COBS 11.2A.