Chapter 2

Conduct of business obligations
2.3B Inducements and research

Application

2.3B.1 This section applies to a firm carrying on MiFID, equivalent third country or optional exemption business.

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

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 G

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 R

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]
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]

(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

(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 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 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 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 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.