

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

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

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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

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	<p>(1) A <i>firm</i> using a <i>research</i> payment account must establish a written policy that sets out how the <i>firm</i> will:</p> <ul style="list-style-type: none"> (a) comply with all elements of ■ COBS 2.3B.4R(4); and (b) address the extent to which <i>research</i> purchased through the <i>research</i> payment account may benefit <i>clients'</i> portfolios, including, where relevant, by taking into account investment strategies applicable to various types of portfolios, and the approach the <i>firm</i> will take to allocate such costs fairly to the various <i>clients'</i> portfolios. <p>(2) A <i>firm</i> must provide the policy established under (1) to their <i>clients</i>.</p> <p>[Note: article 13(8) of the <i>MiFID Delegated Directive</i>]</p>
2.3B.13	G	<p>A <i>firm</i> should retain control over the overall spending for <i>research</i>, the collection of <i>client research</i> charges and the determination of payments.</p> <p>[Note: recital (28) to the <i>MiFID Delegated Directive</i>]</p>
2.3B.14	G	<p>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 <i>firm</i> may wish to consider setting a budget for a group of <i>clients</i> who would benefit from the same <i>research</i>, for example because they have portfolios that are managed according to similar investment strategies. It may be appropriate to operate a dedicated <i>research</i> payment account for such a group.</p>
2.3B.15	G	<p>Where a <i>firm</i> charges a <i>client</i> under ■ COBS 2.3B.4R(1), that charge should be for an amount of <i>money</i> owed to the <i>firm</i>. Therefore, provided it is collected by the <i>firm</i> only when that charge becomes due and payable, that <i>money</i> will not be <i>client money</i> held by the <i>firm</i> for the <i>client</i> who owed that charge (see ■ CASS 7.11.25R).</p>
2.3B.16	R	<p>Other operational arrangements for research payment accounts</p> <p>If a <i>firm</i> 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 <i>commission</i>, the <i>firm</i> must still indicate a separately identifiable <i>research</i> charge and ensure that the arrangements comply fully with the conditions in ■ COBS 2.3B.4R and ■ COBS 2.3B.5R.</p> <p>[Note: article 13(3) of the <i>MiFID Delegated Directive</i>]</p>
2.3B.17	G	<p>A <i>firm</i> should ensure that the cost of <i>research</i> funded by <i>client</i> charges is not:</p> <ul style="list-style-type: none"> (1) linked to the volume or value of services or benefits that are not <i>research</i>; or (2) used to cover anything other than <i>research</i>, such as charges for execution. <p>[Note: recital 27 to the <i>MiFID Delegated Directive</i>]</p>

2.3B.18	R	<p>For the purposes of ■ COBS 2.3B.3R and ■ COBS 2.3B.4R, a <i>firm</i> may delegate the administration of the <i>research</i> payment account to a third party, provided that the arrangement facilitates payments to <i>research</i> providers, in the name of the <i>firm</i>, for the purchase of third party <i>research</i>, without any undue delay and in accordance with the <i>firm's</i> instruction.</p> <p>[Note: article 13(7) of the <i>MiFID Delegated Directive</i>]</p>
2.3B.19	G	<p>(1) In order that a <i>firm</i> retains sufficient control, and is responsible for, a <i>research</i> payment account when relying on a third party to administer it, the <i>firm</i> should consider whether its arrangements with that third party will ensure that:</p> <p>(a) the <i>firm</i> can collect <i>client research</i> charges relating to a specific <i>research</i> budget into a separate <i>research</i> payment account for that budget, as cleared funds, without undue delay (and, in any event, no later than 30 <i>days</i> after deduction from the <i>client's</i> account);</p> <p>(b) the <i>firm</i> retains sole, full and absolute discretion over the use of the account and the making of payments or rebates;</p> <p>(c) <i>research</i> payment account monies are ring-fenced and separately identifiable from the assets of the third party or, where the third party administrator is a <i>bank</i>, are held on deposit for the <i>firm</i>; and</p> <p>(d) the third party provider has, or its creditors on insolvency have, no right of access or recourse to the <i>research</i> payment account for its own benefit, for example to offset other fees owed by the <i>firm</i> or for use as collateral.</p> <p>(2) The <i>firm</i> remains fully responsible for discharging all of its obligations to its <i>clients</i> 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 <i>clients</i> when deducting <i>research</i> charges from their accounts and procuring <i>research</i>.</p> <p>Disclosure on request of payments made from a research payment account</p>
2.3B.20	R	<p>(1) Where a <i>firm</i> operates a <i>research</i> payment account, it must provide on request to its <i>clients</i> a summary of:</p> <p>(a) the providers paid from this account;</p> <p>(b) the total amount they were paid over a defined period;</p> <p>(c) the benefits and services received by the <i>firm</i>; and</p> <p>(d) how the total amount spent from the account compares to the budget set by the <i>firm</i> for that period, noting any rebate or carry-over if residual funds remain in the account.</p> <p>(2) A <i>firm</i> must also be able to provide the information in paragraph (1) to the <i>FCA</i> on request for all <i>research</i> payment accounts.</p> <p>[Note: article 13(2) of the <i>MiFID Delegated Directive</i>]</p>

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.