



MANAGED FUNDS
ASSOCIATION

L'Autorité des marchés financiers
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Via email: directiondelacommunication@amf-france.org

28 October 2016

**Response to Public consultation by the AMF on the new rules for the funding of research
by investment firms under MiFID II**

Dear Sir/Madam,

The Alternative Investment Management Association (**AIMA**)¹ and Managed Funds Association (**MFA**)² (together, **we**) are grateful for the opportunity to respond to the Autorité des Marchés Financiers (**AMF**) 'Public consultation by the AMF on the new rules for the funding of research by investment firms under MiFID II' (**the Consultation**).³

Our alternative investment manager members operate a diverse range of actively managed strategies which require the consumption of high-quality research from a combination of internal staff and external providers. The new rules provided through Article 24(8) of Directive 2014/65/EU on markets in financial instruments (**MiFID II**)⁴ and Article 13 of Commission Delegated Directive of 7 April 2016 (**the Delegated Act**)⁵ are highly relevant to their businesses when providing portfolio management services to clients.

Overall, we are highly supportive of the proposed guidance and recommendations contained within the Consultation and support future European Securities and Markets Authority (**ESMA**)

¹ AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 1,700 corporate members in over 50 countries. AIMA works closely with its members to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes, and sound practice guides. Providing an extensive global network for its members, AIMA's primary membership is drawn from the alternative investment industry whose managers pursue a wide range of sophisticated asset management strategies. AIMA's manager members collectively manage more than \$1.5 trillion in assets.

² Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

³ Available here: http://www.amf-france.org/en_US/Publications/Consultations-publiques/Archives.html?docId=workspace%3A%2F%2FSpacesStore%2F15f91213-d77a-48d4-b2dc-e63806b708e4

⁴ Available here: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0065&from=EN>

⁵ Available here: <http://ec.europa.eu/transparency/regdoc/rep/3/2016/EN/3-2016-2031-EN-F1-1.PDF>

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guidance to be based on this approach. In particular, we believe that Section 3 of the Consultation provides useful clarity that a research payment account (**RPA**) can incorporate mechanisms for the collection of the client research charge currently used by commission sharing agreements (**CSAs**) – so long as the model meets the various requirements within the Delegated Act and the amounts charged are not linked to the volume of transactions executed.⁶

We are also grateful for the explicit flexibility granted for firms to decide for themselves ‘whether they wish to operate one or more [RPAs]’,⁷ and that budgets may be set taking either: (i) a ‘bottom-up’ approach establishing what each portfolio or type or portfolio needs; or (ii) a ‘top-down’ approach where the budget is set based on the entire firm’s estimated needs.⁸ We consider it important to enable firms to structure their research payment methodologies in the most appropriate manner for their particular businesses and for the benefit of their investors.

Corporate access

AIMA and MFA are supportive of the AMF’s proposals in relation to corporate access services,⁹ in particular to deem ‘straightforward introduction without provision of a service of an intellectual nature’, such as merely providing a ‘concierge’ service, as a minor non-monetary benefit that does not need to be paid for using the research budget.

We consider that such services could clearly be deemed to fall within the definition of a minor non-monetary benefit under Article 12(3)(e) of the Delegated Act, in that the service itself is not of significant value, but it is still capable of enhancing the quality of service to a client and is unlikely to impair compliance with an investment firm’s duty to act in the client’s best interests. We note that most issuers actively want to meet and talk with investors. Accordingly, a concierge service is generally merely administrative to facilitate meetings that the issuer actively wishes to have, rather than providing any added value by occasioning the issuer to meet with investors where it would not otherwise do so. It would be highly inefficient and unnecessary to attempt to put a granular price on such concierge services, simply resulting in the underlying clients of investment firms paying additional fees to brokers and banks. We therefore support the AMF proposal to deem such concierge services as a minor non-monetary benefit.

Nonetheless, we accept that once an additional ‘intellectual’ component is added to the service – such as a detailed briefing recommending a particular strategy in relation to the executive at the issuer - this would take such corporate access beyond a minor non-monetary benefit. We then would support the ability to pay for such corporate access as research using the transparent and pre-agreed research budget. It would be useful for ESMA to be encouraged to promote a harmonized EU approach in line with the AMF’s recommendations through Level 3 guidance.

Commercial services

We appreciate the discussion of certain types of commercial services that firms will need to assess whether they fall within the definition of research. We believe it would be particularly helpful if the AMF would provide additional guidance on how different commercial services will be caught within

⁶ Page 17 of the Consultation

⁷ Ibid

⁸ Page 12 of the Consultation

⁹ Page 10 of the Consultation

the rules, dealt with at section 1.5.C. of the Consultation.¹⁰ For example, granular guidance as to: (i) what will be deemed to be 'research' chargeable to a research budget; (ii) what will not be deemed 'research'; and (iii) what will constitute a minor non-monetary benefit, would assist firms in their compliance efforts.

Fixed income markets

We are concerned that the application of the MiFID II research payment rules to fixed income and other spread-based markets (including FX and rates through applying the research payment rules to macro-economic research) is a very different proposition than applying the rules to equity markets; posing numerous practical difficulties that we fear could undermine the policy objectives of the MiFIDII rules.

One significant concern is that the rules will simply result in additional costs being imposed on buy-side clients. With the exception of independent research providers, fixed income research is typically provided for free and is not accounted for within the execution spread. In our opinion, it is, therefore, highly unlikely that execution spreads will narrow for fixed income instruments following the introduction of the MiFIDII rules, this has been corroborated in our discussions with the sell-side banks and brokers, as none of them anticipate spreads contracting through the application of these rules to fixed income and other spread trading markets. Compelling direct payments for fixed income research will have the result of requiring clients to pay for a service that they currently obtain for free, but without any related service benefit. We are highly concerned that this will simply serve to boost the profit margins of large banks that currently provide fixed-income research for free, but who will be required to charge for the research without any concomitant obligation to reduce execution spreads. Therefore, we believe that the application of these rules to fixed income/spread trading markets will actually impact detrimentally upon investors in funds (through the payment for such research) without any apparent benefit of a reduction in spreads. We suggest that this cannot be the intended consequence of the regulation and it would appear to be difficult to justify on a cost benefit basis.

Our members also stress that it is extremely difficult to place a value on fixed income research, not least because most is of very little value. There will be certain individual pieces that are especially useful, however it is very difficult to predict where and from whom such pieces will come. The value of each individual piece is also entirely dependent upon the recipient and his particular needs. To this end, AIMA and MFA members would recommend that the AMF add fixed income research to its list of minor non-monetary benefits using its power under Article 13(3)(e) of the Delegated Act.

Paying for research from third-country firms that require 'hard dollar' payments

We note that there is a fundamental issue of conflict between the EU research payment rules and the US restrictions on the activities of broker dealers; as a general matter, US broker dealers are in fact prohibited from accepting 'hard dollar' payments for research unless they become registered as an 'investment adviser' under the Investment Advisers Act of 1940.¹¹ This

¹⁰ Page 9 of the Consultation

¹¹ Available online: <https://www.sec.gov/about/laws/iaa40.pdf>

impediment, however, would restrict such US broker dealers from undertaking one of their core activities. One mechanism through which research could be obtained by EU investment firms without conflict with either rule-set would be to obtain and pay for research through an intra-group re-charging mechanism where a non-EU affiliate entity obtains the research through soft dollar payments and passes it on to an EU investment firm in return for a direct intra-group payment. We would recommend and welcome specific AMF guidance be introduced that confirms an EU investment firm may obtain research from a non-EU affiliate in return for an inter-affiliate re-charging arrangement.

Payment for other services than research that are not minor non-monetary benefits

We note that the AMF has included within the Consultation a statement that "services that cannot be described as 'research' can only be funded from an investment firm's own funds, unless they are considered to represent a minor non-monetary benefit".¹² We would be grateful for clarification from the AMF that this relates only to services bundled with other services and that it is not the AMF's intention to prohibit specific investment and ancillary services being paid for directly by an investment firm and from being charged to a client with that client's *ex ante* agreement. We distinguish these specific services, such as trade execution, from bundled non-monetary benefits not key to the specific service in question that could potentially serve as inducements.

As you know, the inducements regime under Article 24 of MiFID II is not designed to address those services that an investment firm pays for directly – either with its own funds or through a specific client charge. Rather, it is intended to capture those additional services and benefits that are provided alongside a particular investment service (for example, research being provided alongside execution services) that could be used to induce an investment firm to do business with a particular provider for reasons unrelated to the quality and price of the service in question (for example, executing with a particular equity broker due to its provision of quality research rather than its quality of execution). Direct and transparent payments for individual services do not raise the potential conflicts of interest and allow clients to see what has been paid in return for what service.

Outside of the area of research, it is an important and accepted current market practice that investment firms agree with their clients as part of their standard terms of business that the client will pay for specific services, such as execution and for those costs to be charged to the client.¹³ We do not believe it was the intention of the Consultation to suggest that such practices cannot continue, but we think it important to raise the matter in our response to suggest further clarification in the final AMF guidance.

We would be very happy to discuss any aspect of this response - in particular, the matter of fixed income research - in an in-person meeting. If you wish to schedule a meeting or have any other questions, please contact Oliver Robinson (orobinson@aima.org) of AIMA or Matthew Newell (mnnewell@managedfunds.org) of MFA.

¹² Page 6 of the Consultation

¹³ We suggest that this is recognised at page 17 of the Consultation when noting the research costs may be charged to clients 'in addition to execution fees'



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Yours sincerely,

/s/

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