Macro Analysis:

The Evolution of Research Payment Optionality in the UK

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Prepared by:
John McGough
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Timeline Snapshot:

Evolution of Research Payment Optionality in UK

1986 – Big Bang Reforms

- Deregulation ends **fixed commissions in UK**, allowing brokers to bundle **research costs** with execution fees.
- **Commission Sharing Agreements (CSAs)** emerge as a mechanism for asset managers to allocate research payments.
- U.S also deregulated fixed commissions a decade earlier giving birth to “Soft Dollars” which enabled the bundling of research costs with execution fees.
- Although well regulated, some instances of abuse occurred where managers used commissions for non-research expenses without proper disclosure.

2001 – Myners Review

- A landmark institutional investment report led by Paul Myners, which addressed concerns that institutional investors were too risk-adverse, potentially limiting investments in smaller companies.
- Called for greater transparency in research payments.
- Regulators propose rebating research costs to clients, but industry opposition prevents full unbundling.

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Timeline Snapshot:

Evolution of Research Payment Optionality in UK
(Continued)

2006 – FSA Consultation

- UK regulators tighten rules on soft commissions and bundled research payments, leading to broader overall CSA adoption.
- U.S. immediately follows with its own Interpretive Release of Client Commission Practices Under Section 28e which clarified the scope of “Research and Brokerage Services” eligibility and enhanced transparency by encouraging clearer disclosure.

2014 – FCA Bans use of CSA to fund Corporate Access

- The FCA prohibits asset managers from funding corporate access with client commissions, forcing firms to transition to direct payments and subscription models.

2018 – MiFID II Implementation

- MiFID II’s unbundling requirements mandate that research and execution costs be paid separately, leading to a significant decline in the use of CSA’s.
- Research Payment Accounts (RPA’s) emerge but face regulatory and operational risk challenges, making them a very unpopular alternative
- While MiFID II offers significant improvements in transparency, accountability and reduces conflicts of interest, unintended consequences particularly for small and mid-cap enterprises prompt a UK Investment Research Review in 2023.

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(Continued)

2023 – UK Investment Research Review

- UK Government review examines **MiFID II's impact** on research availability and proposes greater payment flexibility to support small and mid-cap firms while enhancing the UK's Capital Markets competitiveness on the world stage.

2024 – FCA PS24/9

- Introduces **joint payment optionity** for MiFID firms managing **segregated mandates,** allowing combined payments for research and execution under strict transparency rules.

Key Benefits of PS24/9

- **Greater flexibility** by allowing managers to make joint payments for 3rd party research and execution.
- **Enhancing Global Competitiveness** aligns UK managers with international practices.
- **Improved research coverage** – addresses declining research availability, particularly for small mid-cap companies.
- **Operational Efficiency** - Reduces administrative burdens associated with RPA's.

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(Continued)

Key FCA PS24/9 Requirements

- **Fund or Strategy-Level Budgeting** – Research should be budgeted at fund or strategy level and disclosed on a summary level to clients, without requiring investor approval.

- **Formal Research Policy** – Firms must document approval procedures, cost allocation methods, and research provider selection criteria.

- **Confidential Research Spending Disclosure** – Research provider budgets can be categorized (e.g., investment banks, mid-tier brokers, independent firms) rather than disclosed individually.

- **Best Execution & Value Assessment** – Ensures managers optimize research funding without overpaying on a purely bundled basis.

Key FCA PS25/4 Benefits

- Extends **joint payment flexibility** to **fund managers**, (**UCITS and AIFs)** along with segregated accounts.

- Clarifies that **each fund does not need its own CSA** to adopt the payment option, firms can instead establish centralized CSA structures.

- **Supports CSA-based research funding**, improving access to high-quality research**, particularly for small and mid-cap companies.**

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Conclusion

- With **PS24/9** and **PS25/4**, the **FCA** tackled a critical issue in the **UK capital markets**, and to their credit, they introduced a set of new rules that are both **practical** and **effective** for industry participants. The framework provides **greater flexibility** while maintaining **transparency and compliance**, ensuring a more adaptable research payment structure for UK firms.

- At the request of **HM Treasury**, the FCA tackled concerns stemming from **MiFID II's unbundling provisions**—working under a tight timetable to design reforms that enhance investment research accessibility. The new framework supports small and mid-cap companies, ensuring they can secure the capital needed to grow while remaining listed on the London Stock Exchange.

- UK asset managers and brokers can take confidence in the continued global expansion of Commission Sharing Agreements which have become a widely embraced industry practice. Fortunately, the tools required to comply with PS24/9 are readily available in the marketplace and the next crucial step for **asset managers** is to carefully **evaluate technology providers and** selecting the best-fit solution that aligns with their needs, workflows and budget.

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