Financial Conduct Authority - CP21/9: Changes to UK MIFID's conduct and organisational requirements – Consultation

UK Equity Markets Association (UKEMA) Consultation Response Submission

Overview/ Summary

Over the last year, public markets have proven that they are the lifeblood of our economy and will continue to have a key role in the post COVID recovery. The investment community injected more than £46 billion into UK plc since the first lockdown as companies sought to raise fresh capital.

However, there is still a great deal of uncertainty about the future of public markets in the UK, with concerns about our future relationship with EU, regulatory issues and increasing public debt affecting confidence. Capital markets must continue to play a part in unlocking growth, especially as a recent survey by Peel Hunt and the QCA (2021) shows that 98% of investors plan to increase or maintain their exposure to UK mid and small-cap companies.

The UK Equity Markets Association (UKEMA) is a newly established grouping of mid-cap and small equity brokerage firms. UKEMA seeks to represent its members by increasing awareness of small and mid-cap equity investment brokers' value in supporting SMEs to access capital to reach their potential and improve regulation by engaging with policy makers and regulatory bodies.

UKEMA is supportive of efforts to reduce the burden of previous MiFID requirements in order to increase market participation, support the drive to grow the number of listed companies, and increase the liquidity that provides cheap and reliable access to capital for businesses contributing to economic growth.

Consultation responses

Q1: a. Do you agree with our proposal to create an exemption for SME research below £200m provided the research is offered on a rebundled basis or for free? **No**

b. If yes or no, please explain your views.

The UK Equity Markets Association (UKEMA) welcomes the principle of a proposed exemption for SME research below £200m on a rebundled basis, which would permit greater flexibility and reduced bureaucracy in the provision of stockbroking services. Efforts to increase the provision of research would also be supported by investors, with research conducted by the Quoted Companies Alliance and Peel Hunt (2021) (link) finding that 56% of investors say that more independent non-sponsored research would raise their level of interest in investing in companies covered. The same report demonstrated that 78% of investors and 73% of companies who replied think that UK mid and small-cap companies should be exempt from MiFID II unbundling requirements.

However, UKEMA strongly opposes the inclusion of a provision for such research to be provided 'for free', which will have significant – if unintended – negative consequences on the research coverage of this cohort of companies.

In practice, a clause allowing for research to be provided 'for free' would lead to a price war, with asset managers attempting to carve out research on companies sub £200m for free to drive down research payment levels. The inevitable consequence of this would be to disincentivise brokers from producing this type of research, exacerbating the low-level of coverage and in turn making it harder for SMEs under £200m to access the funding they wish to attract given their comparative inability to pay for research to be written on them and the reluctance of the Exchanges to pay for such research to be produced.

For example, if a broker currently produces 30% of its research coverage under £200m, it can reasonably be expected that any buy-side client would seek to reduce their research payment commensurately, leading to a push down in research payments, and so in research coverage.

This would have a significantly detrimental impact on the companies affected. For context, 568 of the 723 AIM listed company have a market capitalisation below £200m (i.e. 78%). Of these, 236 have research on them. This therefore leaves just under 60% of sub £200m AIM listed companies without research coverage. Of the 601 Main Market listed companies, 52 have a market capitalisation below £200m and 30 have research written on them.

In order for the proposed changes to rebundling to deliver the objective of increasing the research coverage on this cohort of companies, it is therefore essential that references to research being provided 'for free' are removed.

Additionally, if the proposal is amended to offer research only on a rebundled basis (and not for free) then UKEMA believes that the market cap limit should be increased to £1bn, in order to allow a UK small cap fund to treat all stocks on a bundled basis. This would prevent the UK from placing itself at a comparative disadvantage in relation to the rules applying within the EU, which enable rebundling up to the threshold of €1bn, equivalent to 88% of EU27 companies.

There are also practical questions around how a cap would interact with changes in the market capitalisation of companies as they rise above or fall below a £200m threshold, which would need to be addressed.

Q2: a. Would you be likely to take advantage of the proposal to rebundle for SME research coverage? Yes

b. If yes or no, please explain your views.

UKEMA member firms would welcome the opportunity to provide rebundled SME research, but – as outlined above – it is expected that such research would not be provided for free and that should research payments be reduced, sub £200m research would as a consequence likely be excluded from research offerings.

Q3: a. Do you agree that an industry-led initiative to fund research would be capable of addressing low coverage of SMEs? No

b. If yes, we would welcome your suggestions on how this can be developed. c. If yes or no, please explain your views.

If research is to have a commercial purpose it needs to involve some form of payment from the buyside if it is to avoid the risk of diminishing in quality and, by extension, in value. In simple commercial terms, brokers will write research on stocks if they can expect to be paid to do so.

Should buyside firms refuse to pay a fair price for that research – which would be exacerbated if it could be offered for free – then it is likely that brokers will simply reallocate research resources to areas where it is able to secure payment.

Q4: a. Do you agree with our proposal to include in the list of minor non-monetary benefits third party research received in connection with investment strategies primarily relating to FICC instruments? Yes

b. If yes or no, please explain your views.

The UKEMA agrees that FICC research should be a minor non-monetary benefit.

Q5: a. Do you agree with our proposal to include research provided by IRPs in the list of minor non-monetary benefits? Yes

b. If yes or no, please explain your views.

While UKEMA members do not engage in IRP research, we recognise the important purpose served by IPRs and therefore support the inclusion of such research in the list of minor non-monetary benefits as a means to maintain and improve the provision of research and to support the health of the broader market.

It is nevertheless important – as with other forms of research – that IRP research should have some form of transparent commercial basis for its distribution, whether issuer sponsored or a different classification specifying who it has been paid for, so that investors can understand and appreciate its nature.

Q6: a. Do you agree with the circumstances in which the exemption applies i.e. where the IRP is not engaged directly or indirectly in execution services? **Yes**

b. If yes or no, please explain your views.

Yes, though we note that an IRP that was engaged in execution services would by definition no longer be technically regarded as being independent.

Q7: a. Do you agree with our proposal to include in the list of minor non-monetary benefits openly available written material? **No**

b. If yes or no, please explain your views.

Due to its nature, most firms cannot provide their research to retail investors and indeed are required to attach a disclaimer to research making clear that investment advisory services are not provided to retail clients and is directed at investment professionals, high net worth companies and/or high net worth individuals only.

As such, we recommend that this proposal be amended to include in the list of minor non-monetary benefits written material that is made openly available from a third party to any firms wishing to receive it.

Q8: a. Do you agree with our proposal to remove the obligation for execution venues to produce execution quality reports consistent to the format prescribed under RTS 27? **Yes**

We are supportive of this proposal, given the highly onerous nature of these reports, which often needed to be outsourced at significant expense.

Q9: a. Do you agree with our proposal to remove the obligation for firms who execute orders to produce reports about their order routing and execution outcomes obtained consistent to the format prescribed under RTS 28? **Yes**

b. If yes or no, please explain your views.

We are supportive of the proposal to remove the requirement to produce these reports. UKEMA members have found the obligation to produce these reports (and previously RTS27 reports) to be complex, extremely time consuming and disproportionately challenging.

Neither set of reports add any real value or indeed greater transparency for market participants, and certainly not for the average retail investor.

About UKEMA:

About the UK Equity Markets Association (UKEMA)
The UK Equity Markets Association (UKEMA) is a newly established and growing group of small and mid-cap equity brokerage firms. UKEMA represents its members by increasing awareness of small and mid-cap equity investment brokers' value in supporting SMEs to access capital to reach their potential and improve regulation by engaging with policy makers and regulatory bodies.

UKEMA members trade in over 1,700 companies' shares, representing 87% of all UK listed issuers.

Its membership includes Peel Hunt, Shore Capital, Winterflood, Numis, Arden Partners, Stifel, Liberum and finnCap.

What does UKEMA do?

UKEMA's members work together to reduce market access barriers and help policymakers as they develop new frameworks to support and develop the regulation of equity markets. To do this UKEMA seeks to ensure domestic regulation provides appropriate protections without being overly burdensome in order to support public markets and the essential liquidity they provide.

UKEMA supports economic growth

Small and mid-cap equity brokerage firms help SMEs reach their potential, supporting the UK's post-pandemic economic recovery. UKEMA promotes solutions to allow UK equity markets to thrive, supporting the drive to grow the number of listed companies and increase competition, and helping to make the market more resilient to crises.

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