Virtu Europe Trading Limited
North Dock One, Fifth Floor, 91-92
North Wall Quay, Dublin 1, Ireland,
D01 H7V7

t:00. 353. 1 6338000
f:00. 353. 1 6338010
www.virtu.com

Financial Conduct Authority

12 Endeavour Square

London

E20 1JN

United Kingdom

Re: CP24/7 Payment Optionality for Investment Research

Dear Gergana, Gerard, and team,

On behalf of Virtu Financial, we would like to thank you for allowing us to participate in your consultation in relation to CP24/7.

We equally wish to thank you for engaging with us along the way as you structured CP24/7. We appreciated being able to speak with you on several occasions to provide buy side feedback as well as data. We hope this has been helpful in your efforts to deliver CP24/7.

Following your invitation within the opening sections of CP24/7 to do so, we hereby submit our responses to all your questions, listed in Annex 1. This submission is the culmination of internal reviews and discussions between our commission management team and other firm disciplines, as well as feedback from engagement with several buy side firms both in the UK and globally in relation to this consultation paper.

Once again, on behalf of Virtu Financial, we wish to thank you for the opportunity to participate in this important milestone for the financial services industry in the UK. We wish you well in your next steps towards the publishing of the updated rules and guidance.

Respectfully,

jack pollina

Jack Pollina

Global Head of Commission Management

Virtu Europe Trading Limited
North Dock One, Fifth Floor, 91-92
North Wall Quay, Dublin 1, Ireland,
D01 H7V7

t:00. 353. 1 6338000
f:00. 353. 1 6338010
www.virtu.com

FCA Consulation on CP24/7: Payment Optionality for Investment Research

Virtu Financial consulation submission

1 - Do you agree with our proposal to create additional payment optionality for investment research?

- Yes

We agree. In conversations with our clients, the feedback has been that this is a positive action which has the potential to benefit market participants, and by extension investors/consumers. It is widely understood that these rules are not a 'silver bullet' in relation to the wider Government objectives/Investment Research Review, a point also broadly communicated in this CP.

We agree with the benefits outlined by the FCA in this paper, such as jurisdictional alignment, promoting competition amongst market participants, and offering lower complexity in how research is procured and paid for by asset managers.

2 - Would you be likely to take advantage of the proposed new payment option?

- Yes

Of the clients we've spoken to, views are mixed. Large managers who have invested in a P&L process are hesitant to reverse course unless they see a benefit to investors and alpha generation. Managers not bound by MIFID but who implemented P&L at an asset owner's request are more willing to move away from it if broker coverage improves. Those using a direct charge RPA strongly hint at adopting a 'bundled' trading model to enhance brokerage coverage. Thus, the uptake in bundled trading may exceed the FCA's expectations (based on CP analysis, e.g., 4.17), by both domestic and global asset managers of all sizes.

Managers with a transaction or direct charge (Swedish model) funded RPA process will recognise the parallels with the new payment option and should find it less cumbersome from a compliance and workflow perspective. Implementing a trading-based funding model requires significant initial and ongoing effort. It remains to be seen how 'modular' the new payment option is for these firms, and if it can be integrated into current workflows with acceptable effort. We expand on this in our following responses.

3 - Do you have any views on key indicators that could act as success measures for the outcomes we are looking to achieve?

For the purposes of this answer, we are not thinking of the wider goals of UK GOV, or the Investment Research Review, and the overall aim to grow the attractiveness of the UK as a market for large and small companies to raise capital.

In the CP the FCA finds that investors are obtaining the research they need under the current rules (albeit largely from abroad). It also finds that the current options available to UK asset managers are either operationally complex or may favour larger firms, impacting competition. The outcomes sought are therefore reduced operational complexity, and to provide the ability for firms of different sizes to compete more fairly and equally.

We submit the following points for consideration regarding key success indicators:

1. Monitor the reduction in operational complexity for firms with an RPA program who also incorporate the new payment option (2.20), comparing both options operationally. The FCA has stated (4.8) that the new option should not render existing options unviable or compel market participants to cease offering them.

2. Ensure the new payment option does not unfairly advantage smaller firms/new entrants over medium-sized firms. Bundling and scalability are explained in Annex 2/41.

3. Monitor if the new payment option increases competition among similar-sized firms (Annex 2/64) and if it attracts greater UK-sourced financing (3.18).

4. Check if the new payment option increases coverage of small and mid-sized issuers by mid-sized research brokers and IRP firms, indicating a possible increase in spend on small and mid-cap research, proportionate to large cap, compared to previous years.

5. Monitor the increase in distribution by research firms focused on small and mid-cap issuers to investment managers.

6. Monitor for a growth in "opaque charging structures, overconsumption of research, and conflicts of interest" that were prevalent before MiFID II. It would be of benefit to asset managers to understand the methodology that the FCA might use to monitor for this (2.31).

4 - Is the proposed new payment option and associated guardrails likely to be more efficient and adaptable than existing options for small, fast-growing or new entrant firms, or for existing users of RPAs?

- Yes

This question focuses on both small/medium (SME) size asset managers/firms (AM), and existing RPA users.

For SME-sized AMs/firms, the FCA's findings indicate that these firms are most likely to have an RPA (RCCA commissions funded) program. We offer a different perspective: as RPA administrators, our client base is diverse, serving various firm sizes, though few of these are very large firms (most very large firms having largely adopted P&L since 2018). Our banking partners also host a wider range of RPA client size than is suggested by the FCA.

For existing RPA users, the operational similarity makes incorporating the new payment option easier. The new option's lack of a "counterparty guardrail" (regularly sweeping monies for research into a firm-controlled bank account) makes it more attractive than the current RPA method, depending on the firm's' risk appetite. Firms could use an administrator to aggregate research commissions accrued via the new payment option without an RPA.

We note that for an existing RPA user, this could require managing both an RPA 'pot' and separate bundled commissions at other brokers, involving logging into broker portals, requesting statements, and running separate reconciliations. This can be streamlined with a third-party administrator/aggregator.

Our view is that the new payment option may be more efficient day-to-day than the RPA model, which, despite providing transparency, can be cumbersome due to the bi-weekly reconciliation required by COBS 2.3B.19G. The proposal under 2.3B.25 - 4 (a) states that firms are responsible for administering accounts for purchasing research from joint payments. Additional guidance on handling the new payment option, including managing joint payment (CSA) balances at the broker level, would be beneficial.

Proposed changes on 2.3B.28R allow for third-party administrators of joint payments, similar to a CSA aggregation model. Updates to COBS 2.3B could align the RPA and new payment option workflows; we suggest a minimum 45 - maximum 60 day window for joint payment trades reconciliation. While the FCA aims to make the new process less prescriptive, a rolling monthly retrospective trade reconciliation could improve both models' adaptability and reduce counterparty risk.

SME/new entrant firms may benefit most from the new payment option. However, large managers not bound by MIFID II, but who adopted its practices, or those paying from P&L, are likely to move to the new trading model for anticipated improved broker research coverage and simplified operations, as indicated by our clients.

5 - Do the guardrails we are proposing around firms' use of the proposed payment option secure an appropriate degree of protection for consumers?

- Yes

The proposed guardrails aim to ensure disciplined research spending, fair cost allocation, value assessment, research price benchmarking, and transparency of costs to clients.

These new guardrails resemble those of the existing RPA option, and so protecting consumers similarly. Proposals like budgeting align with current RPA practices and are consumer-focused. High levels of 'Not Known' or 'Unlikely' responses from market participants to the guardrails (4.33) does raise a question of whether some of the other guardrails, such as the 'no-freerider guardrail' might have been useful substitute or future additions to the currently proposed ones.

The new payment option doesn't offer the same counterparty risk protection as an RPA. However, with proper workflow management, risks are minimized, as seen in North America, APAC, and non-EU countries using CSA programs. For example, managing individual CSA balances at brokers to avoid overfunding reduces counterparty risk.

The FCA states in 2.24 that more firms might adopt the new option, particularly those currently paying for research from their own resources. The new option is intended to maintain sufficient discipline and transparency. We believe medium to large 'P&L' firms would meet these standards if the new payment option is implemented. Since the RPA model's introduction, industry knowledge and best practices in budgeting, disclosures, trading, valuation, and payments have developed, making it easier for 'P&L' firms to create compatible workflows. This alignment is even more pronounced with the new payment option, given its similarity to other global markets (e.g., CSAs in AMER, APAC).

6 - Is the proposed new payment option and associated guardrails likely to facilitate operational efficiencies via increased alignment with the requirements of other jurisdictions when purchasing research from overseas providers?

- Yes

From the CP, the FCA seems reluctant to use globally recognized terms such as 'CSAs' to describe its new payment option. The term 'bundled payment' used throughout the CP (e.g., 4.35) might be problematic: the guardrails and transparency proposed by the FCA are closer to an unbundled CSA payment than a fully bundled payment (e.g., 3 cents per share commission, 1.5 cents execution, remainder for services like research). Clients have expressed confusion over the use of the term 'bundled' in the CP. In North America and APAC, a bundled research payment through trading is viewed as a full-service bundled commission covering both execution and research without separate identification of each component. When managers separate execution from research for transparency, as required by MIFID, it's categorized as a CSA trade in these regions, with established booking and recording processes.

Deeper review of CP 24/7 shows the FCA's 'bundled' term aligns more with unbundled CSA or RCCA/RPA models, similar to practices in NA and APAC. The proposed new payment option and associated guardrails should enhance operational efficiencies by aligning with international requirements for purchasing research, particularly benefiting global firms. The proposed COBS wording calls these 'bundled' trades "joint payments for third-party research and execution services" a straightforward term. However, we suggest reconsidering the shorthand 'bundled' for clarity.

In North America, the FCA's proposed new payment option resembles a CSA model with clear regulatory requirements. If the new process mirrors the current RPA or CSA funding model in NA, managers could maintain one global operational process, enhancing operational efficiency. This streamlined approach might benefit UK capital markets, allowing global firms to trade on a bundled basis (a CSA) within the UK, thus reducing operational friction.

7 - Do you agree with the findings set out in the Analysis section of this consultation paper?

- Yes

The Analysis section is thorough and well-structured. We appreciate the FCA's efforts and agree with much of the analysis, which aligns with our understanding of market structures and offers no surprises. Sections 3.18 and 3.19 provide an unbiased list of market structure changes over the years, while 3.28 offers a realistic view of the impacts from 1) the new payment option, 2) the Investment Research Review, and 3) UK government initiatives on UK capital markets in the short to medium term. Section 3.29 counters the narrative (3.27) that research markets have deteriorated, although it's hard to measure this conclusively.

We would like to present a perspective not covered in the analysis. In the context of smaller asset managers (AMs) being disproportionately affected by MIFID II (3.68): these AMs tend to purchase more research from smaller brokers and independent IRPs because they lack the financial resources to compete with larger AMs for research from larger firms. The existing unbundling rules have made it harder for smaller AMs to access SME research from smaller firms, leading to decreased exposure to small and mid-cap issuers.

We also hold a different view from the FCA on the primary users of RPAs. Virtu manages RPAs for several large AMs, including one in the top 20 globally, as detailed in our response to Q4.

Finally, concerning new smaller AM entrants: they remain at a disadvantage to larger managers in a bundled structure due to smaller commission wallets limiting their ability to buy research, especially from large brokers with higher commission expectations. Nevertheless, bundled payments should help smaller AMs access and afford research from small and mid-sized firms more effectively.

8 - Are there any features of the proposed payment option and associated guardrails that would positively or negatively impact its take-up by firms?

- Yes

Firms may hesitate due to benchmarking requirements and strategy-level reporting, even though many managers already voluntarily comply. These requirements are not present in other regions. Asset managers indicate that third-party benchmarking data may not be accurate or effectively reflect their standing against peers, particularly in environments where managers are reluctant to disclose their research sources. Since no two managers operate identically, comparing the expenditures of one manager to another is complex unless research consumption, interactions, and idea generation are also considered. A manager might not value a research firm's offerings as highly as others do. Additionally, issues arise if a provider used by the manager is not included in third-party benchmarking services.

We'd like to share a quote from a client (mid-large size firm) discussion on this topic, this is their perspective: "We know there's not a set cost that can be compared between firms since the view is quantity and quality for allocation dollars in the vote. To have a comparable benchmark, this focuses on the 'quantity' and not quality which is the more variable component. Knowing pricing is fluid, I would hope this is an item the group digs into deeper because it's complex and we'll end up in pricing discussions with 150+ firms or hiring a vendor. I'm hoping a more general disclaimer on how we assess and allocate dollars works here vs. truly showing data."

We are not certain that benchmarking guardrail has been studied enough at the practical level, ahead of making it a regulation under 2.3B.25 7(b). We suggest that a closer look at how exactly a firm would go about benchmarking, for the reasons described.

The 'most significant research providers' disclosure (4.44) has also generated some head scratching, in discussions with our clients. The feedback is that more colour would be helpful around the FCA's expectations on this disclosure, and that a list of providers is not particularly useful to the customer, even where it details "the benefits and services received from such providers" - 2.3B.30 (4). The level of detail that is expected in these disclosures requires some guidance from the FCA.

Client feedback on the budgeting guardrail reveals uncertainty about its practical implementation, especially for firms using a direct charge/transaction-funded RPA. This concern is influenced by the FCA's intention in CP 24/7 to be less prescriptive (4.24), as seen in the proposed wording of COBS 2.3B.25 R (5b). This approach might be causing confusion, particularly among firms with detailed processes shaped by their understanding of existing rules.

In September 2016, the FCA published CP16/29, section 3.21, stating that "firms can set a research budget that applies to multiple client portfolios or funds with similar investment strategies and objectives, benefiting from the same inputs based on asset allocation and underlying instruments. This allows for budget setting at a desk-level or strategy level, provided the individual and collective portfolios have sufficiently similar research needs. Firms may also choose to set a top-down, firm-level research budget as part of a process that then allocates specific budgets to groups of portfolios based on a bottom-up assessment of research needs." This approach is present in the current guidance, COBS 2.3B.14G, and aligns with the spirit and intention of the current CP 24/7.

Our observation is that the flexibility the FCA offers in budgeting for the new payment option has always been present in the RPA process. Some firms on the buy-side may not be fully aware of how flexible the FCA has been concerning budgeting under COBS 2.3B. Highlighting the similarities in budgeting guidance between the RPA and the new payment option could positively impact the adoption of the proposed payment option by firms using RPAs. It also serves to remind all buy-side firms of the existing budgeting guidance. This is particularly beneficial for firms on a P&L payments structure who are evaluating the proposed payment option or an RPA model, or perhaps both in tandem. Additionally, it would aid UK firms aiming to implement or who have already implemented a global process for their research procurement and payment.

9 - Do you agree with the proposed addition of short-term trading commentary and advice linked to trade execution to the list of acceptable minor non-monetary benefits in COBS 2.3A.19R(5)?

- Yes

We view this as a very positive change. It could encourage asset managers to engage with additional brokers, both in the UK and internationally—particularly in the US—which they may have previously avoided due to concerns about inducement rules. Additionally, this change enables UK sell-side firms to offer (or reintroduce) this category of product, which is particularly significant for UK small cap and mid cap domestic brokers. This could allow them to expand and potentially innovate their offerings.

The introduction of "bespoke trade advisory services intrinsically linked to the execution of a transaction in financial instruments" might also benefit smaller asset managers, who have faced some disadvantages since 2018, as detailed in section 3.68 of this CP.

10 - Do you agree with the deletion of the option for bundled payments to purchase research on companies with a market capitalization below £200 million from the list of acceptable minor non-monetary benefits in COBS 2.3A.19R(5)?

- Yes

Yes, we agree. While well researched (PS 21/20), this option was not embraced by the investment community, perceived as complex to implement and not as comprehensive as the EU's 1 billion cap.

For instance, it was unclear what should happen if a market capitalization fluctuated—whether there was leniency to 'wait and see' if it settled back under £200m, despite the FCA providing operational clarity on this and other aspects in PS 21/20. The tracking of ≤ £200m listings and managing transitions between bundled and unbundled workflows was seen as burdensome, along with the disclosure requirements.

The option for ≤ £200m listings to be classed as a minor non-monetary benefit could have remained, but its removal leads to a more streamlined COBS. This change is celebrated by asset managers and research providers.

11 - Are there any further comments you wish us to consider while finalizing these proposals? If so, please include here.

We have made the following main observations in our submission:

1) The term 'bundling' has confused the buy side (in the UK and globally). They may not have studied CP 24/7 enough to understand that the new payment option more closely resembles a CSA arrangement.

2) The parallels between the existing RPA model and the proposed new payment option are helpful. The new payment option may prove operationally more attractive.

3) Some guardrails, such as disclosures on 'top paid providers', benchmarking, and budgeting, require clarification.

4) COBS 2.3B.19G must be updated to extend beyond 30 days.

We have received many queries from both UK and global firms about whether inducement rules are going away, based on this CP. Clarification or guidance (i.e., a statement, frequently asked questions or an explanatory communication) that the inducement rules will remain, aside from the three carve-outs proposed in 2.3B.3R, would be helpful for the asset management community.

Client feedback indicates that the inducement rules around access to new research providers (brokers) should be addressed. The acceptable minor non-monetary benefits (MNMBs) as outlined in COBS 2.3A.19 are viewed as restrictive, particularly the three-month trial window - COBS 2.3A.19F(i). It would be useful to review and ensure that the acceptable MNMBs rules are functioning well, especially for SME brokerage firms covering UK small/mid cap firms. Misunderstandings around inducements and MNMBs may hinder these firms from onboarding new clients. A reminder from the FCA of these rules may encourage buy-side firms to rethink how they classify inducements and MNMBs, highlighting potential domestic economic benefits.

This CP presents proposals for reduced operational complexity and fairer, more equal competition for the buy-side and sell-side in managing non-induced research programs. The same consideration should be given to corporate access (corp axe). We understand that with the current GBP200m cap, "the inducement risks are lower, reflecting the fewer introductions related to SME research" (PS21/20). We also understand the FCA's stance that charging for arranging introductions under corp axe has the potential for inducements. The FCA has documented (2019 multi-firm review) an evolution of corp axe in the UK from broker-led introductions to more direct B2B/Investment Relations-led introductions. This does not reflect today's market structure, particularly in other regions (North America, EU, APAC). In the UK, our experience is that mid-sized asset managers still rely significantly on brokers for corp axe.

We highly recommend a review of the inducement rules around corp axe. If bundled trading with guardrails is possible (and FCA monitors these), a similar approach should be feasible for corp axe. Global alignment would allow corp axe to be paid from dealing commissions, with added FCA guardrails. Currently, UK managers are disadvantaged compared to their global peers.

12 - Do you have any comments on our cost benefit analysis?

The CBA Annex provides detailed market context, including the EU market, supported by FCA Survey results. Paragraph 25 is a notable baseline, highlighting how the EU sell-side's approach to supplying research has changed over time. This is a new observation to us, as clients have more typically discussed the US sell-side in the past year or two since the Listings Act was announced.

Paragraph 27 mentions that sell-side firms need to offer trading and research capabilities in public equity, which many firms (approximately 470 "affected by our proposals") do not provide. We are uncertain about this point and it would be interesting to see the data supporting this statement.

While the Key Assumptions are well explained, they are acknowledged as not particularly robust due to mixed evidence.

Paragraphs 39 and 40 clearly explain why estimating any possible benefits to the new payment option is currently difficult, with the reasoning appearing sound.

Regarding paragraph 51, respectfully we are unsure if the FCA fully appreciates the costs of running an RPA. Operationally, the RPA involves banking and payment fees, costs borne by the RPA owner. There may also be an administrator cost. If the owner switched to bundled trading, brokers would likely track and incorporate research payment operations costs into their rate card, renegotiated periodically. Therefore, the RPA model is unlikely to be more expensive over time than a bundled trading setup with brokers.

For paragraph 65, an indication of when these reviews might take place would be useful.

13- Do you hold any information or data that would allow assessing the costs and benefits considered (or not considered) here? If so, please provide them to us.

Differences Between US and UK Regulations:

- US SEC CSA rules allow for Payment of Corporate Access with client money, the UK does not. Other EU markets also allow the same as the US, such as France.
- US CSA rules do not allow Principal transactions for CSA funding, the UK does.
- SEC allows for the payment of brokerage services from CSA, the FCA does not. Some other EU countries also allow it.
- US managers can still trade fully bundled with no separation of execution from research commission. In the UK, managers must separate execution from research.
- SEC rules allow for cross subsidization of research cost under 28(e) rules, the UK does not.
- SEC allows inducement of research without explicit payment, UK does not.
- EU rules allow for the breaking up of a block trade with different commission rates on portions, the SEC does not allow this. Trades in the US must have same average price and gross commission. The UK allows different parts of a block trade to have different commission components.