Adam Wreglesworth
Wholesale Conduct Policy & Client Assets
Markets Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

24th February, 2014

Dear Mr Wreglesworth,

Re: Consultation on the use of dealing commission rules

Thank you for giving us the opportunity to comment on your consultation on the use of dealing commission rules.

The Investor Relations Society's mission is to promote best practice in investor relations; to support the professional development of its members; to represent their views to regulatory bodies, the investment community and government; and to act as a forum for issuers and the investment community. The Investor Relations Society (IR Society) represents members working for public companies and consultancies to assist them in the development of effective two way communication with the markets and to create a level playing field for all investors. It has over 670 members drawn both from the UK and overseas, including the majority of the FTSE 100 and much of the FTSE 250.

The IR Society welcomes the FCA's review into improving the use of dealing commission and believes the industry can become more transparent and efficient. Furthermore it is important that the industry is seen to be aligning incentives among intermediaries to promote market integrity and competition in the interests of customers. However, we were surprised to see that in section 1.27/1.28 of your paper in the section "who does this consultation paper affect" there was no mention of corporate issuers. We are concerned there will potentially be unintended consequences impacting some issuers, especially those in the small- and mid-cap end of the market.

We address all three questions from your proposal in our submission below, and our key points from our response can be summarised as follows:

- The Society encourages greater transparency surrounding the use of dealing commission and assurance that investment managers are acting in the best interests of their customers.
- We expect one-on-one meetings between corporate issuers and institutional investors to continue as an important part of the engagement process.
- Changes in the cost structure of how corporate access is paid for should not be borne by corporate issuers alone.
- With a shift in the corporate access model, the greatest cost burden is likely to fall on the small- to mid-cap companies who rely on external resource support and yet have restricted budgets.
- A restriction on ‘paid for’ research may result in a reduction in sell-side coverage but benefit independent research houses.
- Lack of sell-side coverage will impact smaller-cap companies which may result in disproportionate valuation anomalies.

Q1: Do you agree with detail of the rule and guidance changes we have proposed?

The IR Society encourages greater transparency of the use of dealing commission and clarity as to the capacity in which the broker is acting. From the corporate issuer perspective, there is currently some opacity in who is paying and what is being paid for, specifically surrounding non-research services such as corporate access. Asset managers should be declaring it if they are using client funds to pay for services. We would therefore welcome a more open marketplace and assurance that investment managers have a duty to act in the best interests of their customers.

We are in favour of more transparency on costs. We are concerned that many brokers and fund managers appear to be unable to provide any clarity to issuers on what is paid for or by whom. While we maintain that meetings with company management are an important part of the investment and engagement process, issuers should be aware of who is paying to see them and fund managers should clarify to end clients what they are paying for. Brokers should also be making clear to the corporate issuers if they are being paid by investors for the meetings, as in many cases the corporate may also be paying the broker for the same service (as part of a corporate broking retainer fee). Improved transparency from all sides would represent a more favorable situation for all parties and would encourage better investor stewardship.

We do however expect engagement meetings to continue, as the principle of meetings between company management and investors is fundamental to the stewardship process. It is a two way process and an activity that should not be rationed.

Furthermore, we support the FCA's proposal for tighter evidential tests for 'substantive' research. We maintain that research should be useful, diligent and based on a variety of analyst views. Definitions though are always open to interpretation and once a set "rule" is defined, ways will inevitably be sought to circumnavigate that. We believe the process would need monitoring and regular review to ensure ongoing transparency.

On the proposed guidance surrounding dealing commission charges and ensuring fund managers act in the best interests of their customers, we believe it is possible for investment managers to value research on a relative basis (and indeed they already implicitly do), if there are a number of analysts covering a company. However, to value research accurately and obtain an absolute value is currently significantly more challenging. Some corporate issuers note that the more strategic 'thought pieces' issued by research houses once or twice a year add more value than the research issued immediately after results announcements. We also hear of increasing cases where brokers are requested to write a specific piece of research and are paid for it separately. So we believe some element of guideline pricing is coming into the market. In addition, paid for research houses may give a steer on pricing, albeit their services encompass more than just the written research.

Investors are increasingly looking for differentiated research and sourcing this from independent (often non-regulated) suppliers. Equally management consultants have for years been providing research contextual reports. So we think absolute pricing could be arrived at but it would take some time to evolve to appropriate price levels.

Q2: Do you agree with the justification and cost benefit analysis for these changes?

We support the FCA's approach and review to improve the use of the dealing commission regime. We also support the belief that the industry can become more transparent and efficient. With this in mind, the use of dealing commission can be better managed if all fees are clarified up front.

Better transparency should result in more productive and quality engagement between issuers and fund managers. Corporate brokers will provide better institutional targeting, higher quality roadshows, and with a focus on longer-term shareholders if there is a more selective approach by fund managers to the purchase of goods and services. We see this as a positive step and one we would encourage. We believe in recent years, the quality of the services being offered to companies has been diminishing with the result that we have already seen large companies (FTSE100) stepping up their own internal resources for both investor targeting and investor roadshows.

With a change in the proposed structure on how meetings are paid for in the future, we feel strongly that the cost of corporate access should not fall solely upon corporate issuers, who already face a substantial and costly compliance burden as well as time and resource constraints. This may impact the mid- to smaller-cap companies in particular, who have less in-house resource as well as budget. On the one hand, if companies pay in part then they have more control and accountability than relying on brokers. On the other hand, if fund managers are more transparent about costs and how they are paying, it is a justifiable cost for investors to keep up to date with their investments.

However, with a ban on the use of dealing commission to pay for research we would anticipate that over time there would be a reduction in sell-side research coverage of companies. This would have more impact on mid- and small-cap companies who, with a reduction in coverage may end up with limited visibility in the market. There is therefore the potential for erroneous valuations with a potential decline in the quantity of research on companies.

The cost burden could move to companies who may then seek paid for research. This could then open up opportunities for research businesses (outside investment banks) and independent research houses to enter the research market. It seems unlikely all these providers would be regulated, opening the possibility of published research having a significant impact on share prices, with investors having commissioned that research and potential for unequal dissemination of information. Issuers may be required to work with a wider range of research houses all looking for information and access. This will be a complex process to manage, albeit the digital era and web-based systems may help considerably in that process.

Q3: Do you believe there are likely to be any material incremental costs or benefits which we have not considered here?

If the proposal that the provision of corporate access does not meet the criteria under the use of dealing commission rules, then this may limit the possibilities of investor stewardship and place a resource and cost burden on issuers, in particular on the small- to mid-cap companies and especially those in less high profile sectors. Corporate brokers provide useful investor contacts which an in-house team cannot always replicate, and the smaller listed companies may be unable to access investors by other means so may be disadvantaged by change. There will also be consequences if investors overall pay less for corporate access if it is paid for from internal resources. This may reduce the service the brokers are prepared to offer and again potentially disadvantage those small- and mid-cap companies more reliant on their services as part of their broking relationship.

We do not see it as appropriate in the engagement process that there should be a full shift of the cost burden of corporate access onto issuers. Meetings between management and investors are of benefit to both parties and the cost burden of that should be shared accordingly.

If payments for corporate access are rationed in the future, then there are various scenarios that may develop:

i) Brokers and investors find a way to redefine corporate access as a research service – resulting in little change;

ii) Companies rely on house brokers only to arrange roadshows – which might mean the quality of roadshows reduces due to lack of incentives;

iii) Companies pay other brokers or third party intermediaries to arrange roadshows – an added cost to corporates;

iv) New and innovative ways to engage with investors develop including web-based technology platforms to arrange roadshows – it may well make sense for the buy side to embrace this;

v) Company internal IR departments grow (as per the European model) and arrange their own roadshows – an added administrative resource and cost burden for companies.

Whether or not there is a ban on the use of dealing commission to pay for research we anticipate cost pressures and changing market dynamics in investment banking will result in sell-side coverage contracting over the next few years. As previously mentioned, this could lead to valuation anomalies among the smaller cap companies, who may subsequently also fall under the radar of investors. This would not be to the benefit of retail shareholders or to the markets generally if listing proves to only give visibility to the larger cap companies.

Costs of research may transfer to the fund manager, who may also face time and resource constraints. Consequently this may adversely affect the ability to follow and invest in companies, biased sector selection and market valuation anomalies.

In summary, all parties, including corporate issuers and end investors would welcome clarity on who does what and how the economics are shared. All parties have an important role to play in ensuring that investors and issuers can effectively engage. It is more an issue of transparency.

We hope you find these comments useful and please do not hesitate to contact me if you have any further questions.

Kind regards

Emma Burdett
Chair of The Investor Relations Society's Policy Committee
020 7379 5151 / eburdett@maitland.co.uk