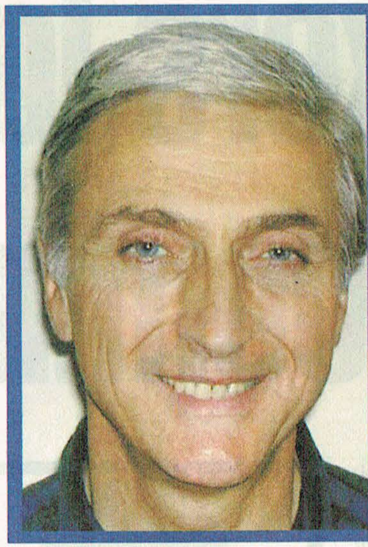
Brokers and research providers say abolition would be harmful, writes Sophie Brodie

Analysts stand up to soft commission ban



'What CP 176 is proposing is the worst of all worlds'

Rusty Ashman, Stockcube

Brokers and independent research providers are making a last stand against a ban on soft commissions by the Financial Services Authority (FSA), the UK regulator. Fund managers are resigned to the abolition of soft commissions as long as they continue to bundle broking and research costs.

The Association of Independent Research Providers (AIRP), said last week in response to the regulator's consultation paper, CP 176, that a ban was unnecessary. It said it would harm those that CP 176 is supposed to help – independent research providers.

A broker close to AIRP said: "A ban would smack of nannyism and show the Treasury was only interested in following its own political agenda rather than reforming market structures to improve returns for investors."

AIRP, formed in July, is in favour of greater price transparency and the chance for independent research houses to compete on a level playing field with large integrated banks. However, it believes that the best way to achieve this is with a mechanism such as soft commission in place, even though it admits that some softing arrangements could be open to abuse. Instead, the association suggests tightening restrictions on the use of soft commissions or fully unbundling costs if softing is outlawed.

Rusty Ashman, managing director of Stockcube, an independent research provider and chairman of AIRP, said: "What CP 176 is proposing is the worst of all worlds. Doing away with soft commission without fully unbundling costs will obscure pricing even further and will drive fund managers away from independent research providers and further towards subsidised research from the big integrated banks."

In the absence of full unbundling, AIRP believes fund managers will first reduce spending on independent research and allocate more commission to investment banks. This is because broker research at investment banks is subsidised and appears free to fund managers.

Only 3% of fund managers polled in a recent survey by Greenwich Associates, the consultancy firm, think full unbundling will occur. Nearly two thirds, 60% believe they will spend less on sell-side research if the FSA demands greater transparency.

One broker at a large US bank in London said: "Some boutique research houses are worried about a ban because soft commission is a big part of their revenue. We are very relaxed with the FSA's proposals. We stopped taking soft commissions a long time ago and have systems in place to unbundle if necessary."

A spokesman for the FSA said: "We will comment on responses to the consultation paper in due course. The paper was not designed to frame the market in a certain way or to encourage people to use certain firms."

AIRP is content, however, to see fund managers bear infrastructure costs, such as Reuters and Bloomberg screens, which could cost them up to £100m (€144m) a year if soft commissions go.

Jamie Stewart, head of institutional marketing and research at Eden Group, a research intermediary, said: "Charging for market information screens is like expecting a hotel guest to pay an hourly fee to use the hotel's carpets."

The debate surrounding CP 176 intensified last week as industry groups jostled to air their views before last week's deadline for responses. The Investment Management Association took the lead, conceding that it could not prove that banning soft commissions would have a detrimental effect on the markets. However, most associations warned of the danger of unintended consequences from changing the system.

One broker said: "We believe the rules currently governing soft commission are sufficient. The FSA has not made the case for change. Doing nothing is a policy option."

According to the Greenwich survey, UK fund managers do not believe that CP 176 will improve performance for investors. Yet, nearly two thirds of them have invested substantial amounts analysing the implications of CP 176 for their organisations.

John Webster, a consultant at Greenwich, said: "Would clients be better served if these firms focused their attention on resolving the pension deficit and liability problems besetting pension funds? Is the regulator fiddling while Rome burns?"

sbrodie@efinancialnews.com