

**CONDUCT OF BUSINESS SOURCEBOOK (USE OF DEALING COMMISSION)  
INSTRUMENT 2005**

**Powers exercised**

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
    - (a) section 138 (General rule-making power);
    - (b) section 140 (Restriction on managers of authorised unit trust schemes);
    - (c) section 156 (General supplementary powers);
    - (d) section 157(1) (Guidance);
    - (e) section 242 (Applications for authorisation of unit trust schemes);
    - (f) section 247 (Trust schemes rules); and
    - (g) section 248 (Scheme particulars rules); and
  - (2) regulation 6 (FSA rules) of the Open-Ended Investment Companies Regulations (SI 2001/1228).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

**Commencement**

- C. This instrument comes into force as follows:
- (1) changes to the Handbook text placed in bold square brackets, irrespective of whether the change takes the form of additional text or deletion of text, come into force on 1 July 2006;
  - (2) otherwise, the instrument comes into force on 1 January 2006.

**Amendments to the Handbook**

- D. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Conduct of Business sourcebook (COB)	Annex B
Market Conduct sourcebook (MAR)	Annex C

**Citation**

- E. This instrument may be cited as the Conduct of Business Sourcebook (Use of Dealing Commission) Instrument 2005.

By order of the Board  
21 July 2005

## Annex A

### Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text. Further, in this Annex, changes to Handbook text placed in bold square brackets, irrespective of whether the change takes the form of insertion of additional text or deletion of text, come into force on 1 July 2006. Otherwise, this Annex comes into force on 1 January 2006.

The following amendment comes into force on 1 January 2006:

...

*material interest* (in *COB*) (in relation to a transaction) any interest of a material nature, other than:

- (a) disclosable *commission* on the transaction;
- (b) goods or services which can reasonably be expected to assist in carrying on *designated investment business* with or for *clients* and which are provided or to be provided under a *soft commission agreement* or in compliance with *COB* 7.18.3R (Use of dealing commission to purchase goods or services).

The following amendments, taking account of the above amendment to the definition of 'material interest', come into force on 1 July 2006:

*material interest* (in *COB*) (in relation to a transaction) any interest of a material nature, other than:

- (a) disclosable *commission* on the transaction;
- (b) goods or services which can reasonably be expected to assist in carrying on *designated investment business* with or for *clients* and which are provided or to be provided [~~under a *soft commission agreement* or~~] in compliance with *COB* 7.18.3R (Use of dealing commission to purchase goods or services).

...

[*soft commission agreement* an agreement in any form under which a *firm* receives goods or services in return for *designated investment business* put through or in the way of another person.]

...

## Annex B

### Amendments to the Conduct of Business sourcebook

In this Annex, underlining indicates new text and striking through indicates deleted text. Where entire sections of text are being deleted or inserted, the place where the change will be made is indicated and the text is not struck through or underlined. Further, in this Annex, changes to Handbook text placed in bold square brackets, irrespective of whether the change takes the form of insertion of additional text or deletion of text, come into force on 1 July 2006. Otherwise, this Annex comes into force on 1 January 2006.

1.3.5 G ...

- (3) offering, giving, soliciting or accepting inducements for the purpose of or in connection with activities falling within the scope of *COB 2.2* (Inducements [~~and soft commission~~]) will apply in this context;

...

1.6.2 R Table Provisions of COB applied to stock lending activity.  
This table belongs to *COB 1.6.1R*

COB	Subject
...	
2.2	Inducements [ <del>and soft commission</del> ]
...	

...

1.6.4 R Table Provisions of COB applied to corporate finance business  
This table belongs to *COB 1.6.3R*

COB	Subject
...	
2.2	Inducements [ <del>and soft commission</del> ]
...	

...

2.2 Inducements [~~and soft commission~~]

...

The following provisions, *COB 2.2.8R* to *COB 2.2.19R* are deleted in their entirety; the text is not struck through.

*COB 2.2.8R* to *COB 2.2.19R* [deleted]

...

Record keeping

- 2.2.20 R (1) [~~A firm must make records of the reports sent to its customers as required by COB 2.2.18R and retain those records for at least three years from the date on which the soft commission agreement to which they relate is terminated.~~ [deleted]]
- (2) A firm must make a record of each payment of disclosable *commission*, and must retain that record for a period of at least six years from the date of payment.
- (3) A firm must make a record of each benefit given to another *firm* in accordance with COB 2.2.6G, and must keep that record for at least six years from the date on which it was given.

...

COB 4 Annex 2

COB 4 Content of terms of business provided to a customer: general requirements

Annex 2.1E This table belongs to COB 4.2.11E

A firm's terms of business (including a client agreement) provided to a customer should, where relevant, include some provision about:	
...	
(14)	<p><del>[Use of soft commission agreements</del></p> <p><del>If the firm is to be authorised under the terms of business to undertake transactions with or through the agency of another person with whom the firm has a soft commission agreement, the prior disclosure required by COB 2.2.16R (Prior disclosure).</del></p> <p><u>Use of dealing commission</u></p> <p><u>If the firm receives goods or services in addition to the execution of its customer orders in accordance with COB 7.18 (Use of dealing commission), the prior disclosure required by COB 7.18.12R (Prior and periodic disclosure).</u></p> <p>...</p>
...	

...

5.10.2 G ... It also supplements other provisions in the *Handbook* (see, in particular, *COB 2.2* (Inducements [~~and soft commission~~]), *COB 7.1* (Conflict of interest and material interest) and *COB 7.16* (Investment research).

...

5.10.5 G ...  
(5) having internal arrangements under which allocation recommendations are not determined by the level of business which a *firm* does or hopes to do with any other *client* (see also *COB 2.2* (Inducements [~~and soft commission~~])); for example:

...

After *COB 7.17*, insert the following new section, *COB 7.18*, which is not underlined:

7.18 Use of dealing commission

Application

7.18.1 R (1) This section applies to a *firm* that acts as an *investment manager* when it *executes customer orders* that relate to the *designated investments* specified in (2).

(2) The *designated investments* for the purposes of (1) are:

(a) *shares*; and

(b) (i) *warrants*;

(ii) *certificates representing certain securities*;

(iii) *options*; and

(iv) *rights to or interests in investments* of the nature referred to in (i) to (iii);

to the extent that they relate to *shares*.

Purpose

- 7.18.2 G *Principle 1 (Integrity)* requires a *firm* to conduct its business with integrity. *Principle 6 (Customers' interests)* requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly. *Principle 8 (Conflicts of interest)* requires a *firm* to manage conflicts of interest fairly, both between itself and its *customers* and between a *customer* and another *client*. The purpose of this section is to ensure that an *investment manager's* arrangements in relation to dealing commissions are transparent and demonstrate accountability to *customers* where *commissions* are spent in acquiring services in addition to *execution*, and consequently that *customers* are treated fairly.

Use of dealing commission to purchase goods or services

- 7.18.3 R (1) An *investment manager* must not *execute customer orders* under arrangements coming within (2), unless the conditions in (3) are satisfied.
- (2) The arrangements referred to in (1) are that the *investment manager*:
- (a) *executes* its *customer orders* through a broker or another *person*;
  - (b) passes on the broker's or other *person's charges* (whether *commission* or otherwise) to its *customers*; and
  - (c) in return for the *charges* referred to in (b), receives goods or services in addition to the *execution* of its *customer orders*.
- (3) The conditions referred to in (1) are that the *investment manager* has reasonable grounds to be satisfied that the goods or services in (2)(c):
- (a) (i) are related to the *execution* of trades on behalf of the *investment manager's customers*; or
  - (ii) comprise the provision of research; and

- (b) will reasonably assist the *investment manager* in the provision of its services to its *customers* on whose behalf the orders are being *executed* and do not, and are not likely to, impair compliance with the duty of the *investment manager* to act in the best interests of its *customers*.
- 7.18.4 E (1) Where the goods or services relate to the *execution* of trades, an *investment manager* should have reasonable grounds to be satisfied that the requirements of *COB 7.18.3R* are met if the goods or services are:
- (a) linked to the arranging and conclusion of a specific investment transaction (or series of related transactions); and
- (b) provided between the point at which the *investment manager* makes an investment or trading decision and the point at which the investment transaction (or series of related transactions) is concluded.
- (2) Compliance with (1) may be relied upon as tending to establish compliance with *COB 7.18.3R*.
- 7.18.5 E (1) Where the goods or services relate to the provision of research, an *investment manager* will have reasonable grounds to be satisfied that the requirements of *COB 7.18.3R* are met if the research:
- (a) is capable of adding value to the investment or trading decisions by providing new insights that inform the *investment manager* when making such decisions about its *customers'* portfolios;
- (b) whatever form its output takes, represents original thought, in the critical and careful consideration and assessment of new and existing facts, and does not merely repeat or repackage what has been presented before;
- (c) has intellectual rigour and does not merely state what is commonplace or self-evident; and
- (d) involves analysis or manipulation of data to reach meaningful conclusions.
- (2) Compliance with (1) may be relied upon as tending to establish compliance with *COB 7.18.3R*.

- 7.18.6 G An example of goods or services relating to the *execution* of trades that the *FSA* does not regard as meeting the requirements of *COB 7.18.4E(1)* is post-trade analytics.
- 7.18.7 G Examples of goods or services that relate to the provision of research that the *FSA* do not regard as meeting the requirements of *COB 7.18.5E(1)* include price feeds or historical price data that have not been analysed or manipulated to reach meaningful conclusions.
- 7.18.8 G Examples of goods or services that relate to the *execution* of trades or the provision of research that the *FSA* do not regard as meeting the requirements of either *COB 7.18.4E(1)* or *COB 7.18.5E(1)* include:
- (a) services relating to the valuation or performance measurement of portfolios;
  - (b) computer hardware;
  - (c) dedicated telephone lines;
  - (d) seminar fees;
  - (e) subscriptions for publications;
  - (f) travel, accommodation or entertainment costs;
  - (g) office administrative computer software, such as word processing or accounting programmes;
  - (h) membership fees to professional associations;
  - (i) purchase or rental of standard office equipment or ancillary facilities;
  - (j) employees' salaries;
  - (k) direct money payments;
  - (l) publicly available information; and
  - (m) *custody* services relating to *designated investments* belonging to, or managed for, *customers* other than those services that are incidental to the *execution* of trades.

- 7.18.9 G The reference to research in *COB 7.18.3R(3)(a)(ii)* is not confined to *investment research* as defined in the *Glossary*. The *FSA's* view is that research can include, for example, the goods or services encompassed by *investment research*, provided that they are directly relevant to and are used to assist in the management of *investments* on behalf of *customers*. In addition, any goods or services that relate to the provision of research that the *FSA* regards as not acceptable under *COB 7.18.7G* or *COB 7.18.8G* should be viewed as not meeting the requirements of *COB 7.18.3R(3)*, notwithstanding that their content might qualify as *investment research*.
- 7.18.10 G This section applies only to arrangements under which an *investment manager* receives from brokers or other *persons* goods or services that relate to the *execution* of trades or the provision of research. It has no application in relation to *execution* and research generated internally by an *investment manager* itself.
- 7.18.11 G An *investment manager* should not enter into any arrangements that could compromise its ability to comply with its best execution obligations under *COB 7.5* (Best execution).

#### Prior and periodic disclosure

- 7.18.12 R (1) If an *investment manager* enters into arrangements for the receipt of goods or services that relate to the *execution* of trades or the provision of research in accordance with *COB 7.18.3R* (Use of dealing commission to purchase goods or services), it must in a timely manner make adequate:
- (a) prior disclosure; and
  - (b) periodic disclosure;
- to its *customers* of the arrangements entered into.
- (2) The adequate disclosure in (1) must include details of the goods or services that relate to the *execution* of trades and, wherever appropriate, separately identify the details of the goods or services that are attributable to the provision of research.

#### Making prior and periodic disclosure in a timely manner

- 7.18.13 E (1) For the purposes of *COB 7.18.12R*, a *firm* should make prior and periodic disclosure to its *customers* in accordance with the requirements of this *rule*.

- (2) For a new *customer*, the *firm* should make the prior disclosure before it conducts any *designated investment business* for him.
- (3) For an existing *customer*, the *firm* should make the prior disclosure by the earlier of:
  - (a) 1 July 2006; and
  - (b) the date that the *firm* makes its first periodic disclosure to its *customers* in accordance with *COB 7.18.12R*.
- (4) A *firm* will make periodic disclosure to its *customers* in a timely manner if it is made at least once a year.
- (5) Compliance with (1) to (4) may be relied upon as tending to establish compliance with *COB 7.18.12R(1)*.

- 7.18.14      G      (1) The prior disclosure required by *COB 7.18.12R(1)* should include an adequate disclosure of the *firm's* policy relating to the receipt of goods or services that relate to the *execution* of trades or the provision of research in accordance with *COB 7.18.3R* (Use of dealing commission to purchase goods or services). The prior disclosure should explain generally why the *firm* might find it necessary or desirable to use dealing commission to purchase goods or services, bearing in mind the practices in the markets in which it does business on behalf of its *customers*. While the appropriate method of making such a disclosure is for the *firm* to decide, this could, for example, be achieved by a change to its *terms of business*.
- (2) In assessing the adequacy of disclosures made by an *investment manager* under *COB 7.18.12R*, the *FSA* will have regard to the extent to which *investment managers* adopt disclosure standards developed by industry associations such as the Investment Management Association, the National Association of Pension Funds and the London Investment Banking Association.

#### Prohibition of inducements

- 7.18.15      R      *COB 2.2.3R* (Prohibition of inducements) does not apply to an *investment manager* that complies with the requirements of this section in receiving goods or services in accordance with *COB 7.18.3R* (Use of dealing commission to purchase goods or services).

## Record keeping

- 7.18.16 R An *investment manager* must make a record of each periodic disclosure it makes to its *customers* in accordance with *COB 7.18.12R* and must maintain each such record for at least five years from the date on which it is provided.

...

- 10.2.5 R Application of conduct of business rules  
This table belongs to *COB 10.2.1R*

Application of conduct of business rules		
Chapter, Section or Rule	Description	Modifications
...		
2.2	Inducements [and soft commission]	[In the case of a <i>regulated collective investment scheme</i> , <i>COB 2.2.8R(5)</i> and <i>COB 2.2.16R</i> to <i>COB 2.2.19R</i> do not apply]
...		
7.18	<u>Use of dealing commission</u>	
...		

...

- 10.6.8 E Content of scheme documents  
This table belongs to *COB 10.6.7E*

Content of scheme documents		
...		
(16)	<p>[<del>Use of soft commission agreements if the <i>operator</i> is to be authorised under the agreement or <i>instrument constituting the scheme</i> to effect transactions with or through the agency of another <i>person</i> with whom the <i>operator</i> has a <i>soft commission agreement</i>, the prior disclosure required by <i>COB 2.2.16R</i>;</del>]</p> <p><u>Use of dealing commission</u> if the <i>operator</i> receives goods or services in addition to the <i>execution</i> of its <i>customer orders</i> in accordance with <i>COB 7.18</i> (<u>Use of dealing</u></p>	

	commission), the prior disclosure required by <i>COB 7.18.12R</i> (Prior and periodic disclosure).
...	

...

11.4.3

R Rules applicable to depositaries  
This table belongs to *COB 11.4.1R*

Chapter	Description	Modifications
...		
2.1 to 2.4	Rules which apply to all firms	<del>[<i>COB 2.2.8R</i>—<i>COB 2.2.20R</i> do</del> <i>COB 2.2.20R</i> does] not apply. ...
...		

...

11.5.2

R Rules applicable to trustee firms which are not depositaries and to which *COB 11.5.1R* (1) applies  
This table belongs to *COB 11.5.1R* (1).

Chapter	Description	Modifications
...		
2.2	Inducements [ <del>and soft</del> <del>commission</del> ]	"Customer" means "trustee" or "trust" as appropriate
...		
<u>7.18</u>	<u>Use of dealing commission</u>	<u>"Customer" means "trustee" or "trust" as appropriate</u>
...		

11.5.3

R Rules applicable to trustee firms which are not depositaries and to which *COB 11.5.1R*(2) applies  
This table belongs to *COB 11.5.1R*(2).

Chapter	Description	Modifications
...		
2.2	Inducements [ <del>and soft</del> <del>commission</del> ]	"Customer" means "trustee" or "trust" as appropriate.
...		
<u>7.18</u>	<u>Use of dealing commission</u>	<u>"Customer" means "trustee" or</u>

...		<u>“trust” as appropriate.</u>
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COB TP 1.2 COB TR1 Transitional Rules for pre-N2 and ex-Section 43 firms at N2

1 Table

(1)	(2) Material to which the transitional provision applies: The <i>COB</i> provisions in Table COB <del>TR 2</del> TP 1.3 with the labels indicated	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
3.2	<i>TSP2</i>	R	<p>Terms of business and client agreements</p> <p>(1) Subject to (2) and (3), a <i>pre-N2 firm</i> will not contravene any of the provisions in Table <i>COB TP1.3</i> labelled <i>TSP2</i> to the extent that, on or after <i>commencement</i>, it is able to demonstrate that it has continued to use, or rely upon, <i>terms of business</i> (including a <i>client agreement</i>), [<del>or a soft commission agreement</del>] given to, or made with, a <i>client</i> before the end of the transitional period in accordance with the corresponding rule</p>	indefinitely	<i>commencement</i>

			of its <i>previous</i> regulator.		
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...

COB TP1.3 COB TR 2 Rules benefiting from transitional relief (pre-N2 and ex-Section 43 firms)

This Table belongs to COB TP 1.2

COB Rule	Rule Heading	Label ETP	
		TSP	
		ETP	TSP
...			
<del>[2.2</del>	<del>Inducements and soft commission</del>		
<del>2.2.8R</del>	<del>Requirements when using a soft commission agreement</del>	ETP1	TSP2
<del>2.2.12R</del>	<del>Allowable benefits provided under soft commission agreement</del>	ETP1	
<del>2.2.16R</del>	<del>Prior disclosure</del>	ETP1]	

...

COB TP 4 Miscellaneous transitional rules applying to all firms

COB TP4.4

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
<u>17</u>	<u>COB 7.18.1R to COB 7.18.16R</u>	<u>R</u>	<u>Use of dealing commission</u>  <u>In relation to any <i>soft commission agreement</i> an <i>investment manager</i> may have on 1 January 2006, the <i>manager</i> may comply with the <i>rules</i> in <i>COB 2.2.8R to COB 2.2.20R(1)</i> (instead of the <i>rules</i> specified in column (2)) until:</u>	<u>From 1 January 2006 to 30 June 2006</u>	<u>1 January 2006</u>

			(1) <u>the date of the expiry of that agreement; or</u>  (2) <u>if earlier, 30 June 2006.</u>		
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...

COB Sch. 1.3 G

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
[COB 2.2.20R(1)]	Periodic reports	<del>Details of soft commission agreements</del>	<del>Date of periodic statement</del>	<del>3 years (from termination of relevant soft commission agreement)]</del>
...				
<u>COB 7.18.16R</u>	<u>Periodic disclosure of arrangements entered into</u>	<u>Details of the receipt of appropriate execution or research goods and services</u>	<u>Date of provision of disclosure</u>	<u>5 years (from when the disclosure is provided)</u>
...				

## Annex C

### Amendment to the Market Conduct sourcebook

In this Annex, underlining indicates new text and striking through indicates deleted text. Further, in this Annex, changes to Handbook text placed in bold square brackets, irrespective of whether the change takes the form of insertion of additional text or deletion of text, come into force on 1 July 2006. Otherwise, this Annex comes into force on 1 January 2006.

- 3.4.14            G A *firm* should take reasonable steps to ensure that it, or any *person* acting on its behalf, does not offer, give, solicit or accept an inducement if it is likely to conflict to a material extent with any duty which a recipient *firm* owes to another *person*. Inducement can include entertainment [~~and soft commissions~~].
- 3.4.15            G If a *firm* gives an inducement and the recipient, although a *market counterparty*, is acting on behalf of *customers*, the *firm* may be subject to the provisions of *COB 2.2* (Inducements [~~and soft commission~~]).

...