MiFID II and its impact on your IR program

WHAT IS MiFID II?

Following the global financial crisis, the European Commission set out to review the **Markets in Financial Instruments Directive (MiFID)**, a cornerstone of European financial regulation. **MiFID II** came into effect on January 3, 2018:

- Increased transparency of markets
- Shift in trading from dark pools towards more structured marketplaces
- Lower cost market data
- Improved best execution
- Orderly trading behavior within markets
- **Costs of trade execution, research and management access are now broken out**

> 'MiFID II unbundled fees for **trade execution**, **research** and **corporate access**'

WHAT WAS IT INTENDED TO DO?

Payment for sell-side research has traditionally been **bundled** with trading commissions. European regulators worried that bundling made research costs opaque to end investors, and they believed that asset managers were inclined to overpay or to sacrifice best execution in exchange for research and corporate access.

MiFID II **unbundled** fees for **trade execution**, **research** and **corporate access**. European asset managers taking sell-side research must pay for it from their own P&L or with a research payment account (RPA) funded by client money, and it must be explicitly priced. Most asset managers have chosen to pay fees from their P&L.

HOW DOES IT AFFECT THE SELL SIDE?

With new price transparency and greater scrutiny of research consumption, **shifts in research spending** by the buy-side are already happening as firms reallocate resources around analyst ranks and coverage.

- **Small-caps** and less popular sectors are seeing a **reduction in coverage** and corporate access
- Small independent houses with **unique specializations** are multiplying
- **Star analysts** as differentiators are in high demand on both the buy and sell side

Why does MiFID II matter to US companies?

> 'Global asset managers are moving to **unbundled research payments** worldwide for simplicity and transparency'

European roadshow support varies widely among brokers as some European investors trim their broker lists. If you have specific targets, make sure the sponsoring broker has a research agreement with them and can set up a meeting for you. If not, you may need to book the meeting directly. Many global asset managers are moving to unbundled research payments worldwide for both simplicity and transparency. As research spend on sell-side research shifts, many buy-side firms are increasing their internal capabilities. Ask questions of your broker partners to ensure you have the right partner in meeting your investor outreach goals.

EVIDENCE FROM EUROPE

- Bulge bracket firms are pricing research aggressively to make sure they stay on almost every asset manager’s broker list
- Independent research providers are challenged as asset managers made quick cuts in the short term
- The equity sales function is changing, even though almost every PM highly values strong sales relationships
- Asset managers are focused on consuming and rewarding high quality research from a ‘pull’ rather than a ‘push’ perspective

(Substantive Research, June 2018)

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INVESTOR FORCES

Many asset managers have hired – or added to existing teams – internal corporate access professionals to manage research relationships (including the broker vote), corporate access (NDRs, field trips, calls) and conference attendance. Asset managers that have internal corporate access teams include:

- Alliance Investment Management
- AXA Investment
- Balyasny Asset Management
- BlackRock
- Capital Group
- Citadel
- Coatue
- Columbia Threadneedle
- Fidelity International
- Fidelity Management & Research
- Janus Henderson
- Norges Bank Investment Management
- Point72
- Schroders
- Surveyor
- T Rowe Price
- Wellington

COMING TO THE USA

US securities rules generally prevent brokers from accepting separate payments for research. To keep the research spigots open after MiFID II, the SEC provided no-action relief allowing US brokers to take payments from European asset managers. What will happen when it expires in April 2020? Several US pension funds, among other money managers, have been vocal in support for a framework similar to MiFID II, believing it will benefit investors. We can expect the SEC to bring the issue up for debate.

IS THE SELL SIDE GOING AWAY?

No. The business is certainly changing, but relationships and on-the-ground knowledge are still highly valued by investors and corporates alike. While there have been instances of investment banks exiting certain sectors or geographies, others are using this period of disruption as an opportunity to hire talent and expand coverage. The expectation is that under MiFID II, asset managers will follow the top analysts in any given sector; bulge bracket firms are differentiating their research and jockeying for the leading spots, while smaller firms are bolstering geographical or sector specializations.

Going forward IROs will need to be more judicious and inquisitive when choosing which sell-side firms to market with in various regions, depending on their client list, sales force and sector strengths.

92% of investors say they view corporate access as important or critical to their investment process

54% of investors will rely more on companies contacting them directly in 2018

(Quantifire/IRS Jan 2018)

EXPLORING ALTERNATIVES

- Micro and small-cap firms have used issuer-paid research
- Some boutique investment banks and independent research firms are organizing NDRs paid for by issuers
- Issuer-paid, technology-enabled corporate access platforms are proliferating

Reduction in published research	Increased workload for IR teams
Fewer analysts covering a stock	Difficulty calculating meaningful consensus
Buy-side taking meetings from fewer brokers	Need for more direct investor outreach
Shifts in sales and corporate access resources	Greater impact on small/mid-cap companies