Asset Management and Investors Council
MiFID II Research Unbundling – Summary of Market Surveys

Introduction

MiFID II defines research as an inducement and can therefore not be paid for by commissions any longer. The objective of the reform is to separate research payments (from the buy side to the sell side) from trading activities (of the buy side). This has far-reaching implications for how investment research is produced and consumed in Europe.

The main difficulty for most asset managers in complying with the new rules on research unbundling is the uncertainty around what the best way to comply is. In trying to help our membership through this uncertainty, AMIC is looking to issue a survey of members about the implementation intention once national rules are in place after July 2017.

In laying the groundwork for our survey, the AMIC Secretariat has decided to draft this summary of surveys which looks into market surveys and summarising their findings in order to illustrate how firms are thinking or are expecting to deal with research unbundling. By conducting this summary of the surveys, AMIC hoped to identify a direction of travel for the industry on research unbundling.

Background

One central reason as to why managers have not been able to identify the best approach is that the regulators, particularly the Financial Conduct Authority (FCA) in the UK and the Autorité des Marchés Financiers (AMF) in France have interpreted the requirements in different and conflicting ways. The AMF published feedback in February 2017 while the FCA published a Position Statement on 3 July 2017.

It is also very difficult to switch course in a material way once a firm formally decides and announces their chosen approach to unbundling, which is another reason why firms prefer to wait until the rules are out rather than commit early and hence why there is a lack of established market best practice.

For most asset managers, the status quo is not an option, so they need to decide whether they are willing to pay for research from their P&L or to set up a Research Payment Account (RPA), and whether to differentiate this approach to equities and fixed income research.

If firms choose the RPA route, this requires developing an efficient infrastructure and agreeing with clients about separate charges or commission sharing arrangements (CSAs). Whether firms pay for it through the P&L or by RPA, they must establish a value for research to their business. In addition, asset managers will need to make these choices for all asset classes where they consume external research, with equities and fixed income likely requiring differing solutions.

Summary of surveys

AIMA published the results of a survey on 21 June 2017 on MiFID II implementation (the full survey is available to AIMA members, but AIMA has kindly let AMIC have a copy), which includes a section on research unbundling. The survey was carried out in April 2017 involving 50 alternative asset managers. The findings on research include the following observations:

- 70% of respondents said they intend to pay for research using an RPA, with 55% planning to fund the RPA via a charge alongside execution commissions, and 15% with a periodic fund charge;
- 30% of respondents said they will pay for research out of P&L with 10% planning to subsequently reimburse the firm from a charge to the fund; and
- 34% of respondents are still undecided on how they intend to pay for research.

A survey from Euromoney called the Fixed Income Research Survey 2016 was held in May 2016 and is the only fixed income focused survey in our list. 2,105 investors were surveyed. The survey is not publicly available. According to this survey:

- 88% of respondents had not set a research budget for 2016;
- 81% of respondents said that they had no plans to change the number of research providers they use;
- 91% of respondents agreed that MiFID II will prompt consolidation as larger asset managers are better able to bear the cost of implementation;
- 84% of the sample do not plan to change the terms and conditions of any funds in response to lower liquidity - of the 16% that are making changes, these are equally split between increasing liquidity backstops, increasing the percentage of gated assets and reducing daily liquidity.

We have included two surveys issued by RSRCHXchange: one in January and an updated one in June 2017.

The January RSRCHXchange survey saw contributions from 234 professionals from 200 different asset management firms. There is no distinction made between equity and fixed income research in this survey. The survey is available from RSRCHXchange on request. According to this survey at that time:

- 50% of respondents were undecided on how they were planning to pay for research under the new rules. 19% said they were considering paying from their P&L, 13% were considering using methods like CSAs, 9% were looking into adding an additional research charge directly to the client and another 9% said they won't pay for research;
- Most respondents (92%) agreed that pricing research is difficult for their research providers;
- 69% of respondents indicated that they currently access research via email, which may be challenging for complying with the new rules, as firms will need to systematically keep track of what research is received and its quality;
- 37% of respondents indicated that the biggest challenge to complying is setting and regularly assessing a research budget, followed by assessing the quality of research (23%), tracking consumption (14%) and setting up and managing an RPA (10%);
- 42% of respondents expect research budgets to remain the same over the next two years, while 21% believe they will fall slightly;
- 60% of respondents said they currently receive research from providers who they have not remunerated, either via dealing commissions or via a direct payment;
- 85% of respondents believe US funds will be impacted by the MiFID II rules;

- 72% of respondents expect to receive and pay for a full research offering from 5 or fewer investment banks, which is significantly lower than the number of investment banks which most asset managers currently receive research for free from;
- Only 33% of respondents expect that more than 60% of their research budget will be spent with the top investment banks after MiFID II takes effect. This is in contrast with similar surveys held in 2012 and 2014 in which 88% and 76% respectively, agreed with that statement. This significant reduction in investment bank research spending means that firms are either expanding their internal research functions or are moving to independent research providers in response to the new rules.

The second survey from RSRCHXchange (also available on request) was conducted in June 2017 and 562 respondents from over 450 investment firms have contributed their views. According to the survey:

- 23% of respondents said they were considering paying for research from their P&L, 10% were considering using methods similar to CSAs, 9% were looking into adding an additional research charge directly to the client and 14% were considering a mixed model approach;
- 36% of respondents were undecided on how they were planning to pay for research under the new rules, down from 50% in the January survey;
- 8% of respondents said they will not pay for research.
- 41% of respondents said they plan to be compliant with the MiFID II rules on research unbundling by the last quarter of 2017, with an additional 44% planning to be compliant in January 2018;
- 54% of respondents said they do not have sufficient clarity on the final rules from their regulators;
- 39% of respondents indicated that the biggest challenge to complying is setting and regularly assessing a research budget, followed by assessing the quality of research (23%), tracking consumption (16%) and setting and managing an RPA (11%);
- 40% of asset managers with AUM below USD 1bn said they have not been contacted by any research providers to discuss their pricing, as opposed to asset managers with AUM above USD 100bn, where only 10% have said the same;
- Only 50% of asset managers with AUM above USD 100bn have been contacted by tier 1 banks to discuss the pricing of their FCC offering. This number goes down in direct relation to AUM, with 30% of for asset managers between USD 10bn and USD 100bn and below 10% for asset managers with AUM below USD 10bn;
- 77% of respondents expect the number of research providers used by their firms to fall;
- 37% of respondents expect research budgets to remain the same over the next two years, while 34% believe they will increase and 29% believe they will decrease;
- 42% of respondents expect that more than 60% of their research budget will be spent with the top investment banks after MiFID II takes effect. This is in contrast with similar surveys held in 2012, 2014 and the one we covered above from January 2017, in which 88%, 76% and 33% respectively, agreed with that statement. This significant reduction in investment bank research spending could mean that firms are either expanding their internal research functions or are moving to independent research providers in response to the new rules. The shift in the trend seen between January and June this year could be a result of conversations between banks and their customers around pricing of research.

Electronic Research Interchange (ERIC) conducted a survey in January 2017. The survey is not publicly available. According to this survey at that time:

- 75% of respondents believe research spending will either remain the same or even fall;

- 38% of buy-side firms are considering expanding their internal research teams;
- 74% of respondents foresee a reduction in investment bank research; and
- 74% of respondents will apply greater scrutiny and will be re-examining their sources of research.

Broker ITG issued a survey in January 2017, with 100 buy-side professionals in North America participating. The survey is not publicly available. According to this survey:

- 43% of North American firms expect MiFID II to have direct impact on them;
- 82% of North American firms plan to fully unbundle all their brokers globally; and
- 59% of respondents plan to continue paying for research using CSA, while 33% expect to use a combination of both CSA and RPA for payments and 8% plan to set up a new RPA ahead of the MiFID II start date.

RBC Capital Markets conducted a survey in April 2017 with 380 buyside professionals contributing. There is no differentiation between equity and fixed income research in this survey. According to this survey (at the time it was conducted):

- 72% of respondents selected CSA/RPA payment mechanism as the funding vehicle of choice;
- 64% of respondents believed that CSA/RPA is the most compatible RPA funding mechanism, while 16% believed it is direct charge and 19% believed it is P&L;
- 61% of respondents expected research budgets to decrease in the long term;
- 39% of respondents believed that allocating research component at strategy level is the biggest challenge with the CSA/PRA model, with administration/operations coming at close second with 36%;
- 30% of respondents believed that administration/operations is the biggest challenge with the direct charge model, with commercial implications coming at a close second place with 26%;
- 49% of respondents believed that commercial implications is the biggest challenge of taking the P&L model;
- 69% of the respondents believed that US funds will be impacted by the unbundling process implicated in MiFID II;
- 63% of respondents believed that pricing research to be complex for their research providers;
- 71% of respondents planned to engage their research providers regarding a research pricing menu;
- 36% of respondents expected to use one RPA provider while 16% expect to use 2 or 3. 38% were undecided; and
- 44% of respondents believed that independent third-party providers will provide the technological solution to commission management.

Main findings

- The majority of surveys identified do not differentiate between the treatment of equity and FICC research, but it is our understanding that firms are likely to treat these differently once the unbundling rules are applied, as payment for FICC trading is not by commission.

- Even as late as June 2017, the surveys show around a third of firms are still undecided on how they plan to pay for research under the new rules.

- Among the firms who have decided, a varying number between 33% and 64% of firms are looking to use an RPA model funded by a charge alongside execution commissions – however, note that this arrangement will only be possible for equity research;

- According to several surveys, between 19% and 30% of firms are looking to pay for research out of their own P&L.

- Several surveys indicate that firms expect research budgets (again, note that these findings do not differentiate between fixed income and equity research) to stay the same or even go down in the near future, with only one indicating an even split between no change, increase and decrease. There could be several reasons for such a conclusion. The unbundling requirements are expected to increase competition between research providers as buy-side firms will look to reduce the firms they consume research from, hence driving the cost of research down. It has been pointed out that that by narrowing down the number of views fund managers look at they will be less able to make well informed decisions – but this assumes they are able to process the vast amount of research they currently receive for free which is not always the case.

- It can be observed that between January and June this year, market participants have been actively thinking about this and are taking decisions around how they will pay for research. In addition to the deadline getting closer, this period coincided with the AMF's February 2017 guidance. Once the UK's rules are issued there may be more clarity in the UK as well.

- A majority of market participants agree that pricing research is difficult. However, a newfound focus might lead to more scrutiny from asset managers and hence to increased demand for high quality research at affordable prices. In the absence of improved research, asset managers are prepared to (and have started to) increase their in-house research teams.

- There is an observable trend of research consumption moving from investment banks to independent research providers. However, later surveys show a slowing down in this trend, perhaps evidence of investment banks engaging buy-side firms about pricing.

- There are still many firms, especially smaller ones, who have not been approached about pricing by research providers.

- A large majority of firms agree that US funds will be impacted by the new European rules. The ITG survey is particularly interesting, because it identifies 82% of North American buy-side firms planning to fully unbundle all their brokers globally, so MiFID II is having a knock-on effect on how research is consumed globally.

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