European Commission Initiative

Quick fix on Research

AMAFI's contribution answer

About AMAFI. Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. It mainly acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI has more than 150 members operating for their own account or for clients in equities, fixed-income products and derivatives. Nearly one-third of its members are subsidiaries or branches of non-French institutions.

AMAFI appreciates the opportunity to comment on the Commission's delegated directive amending the delegated directive (EU) 2017/593 as regards the regime for research on small and mid-cap issuers ("SMEs") and on fixed-income instruments to help the recovery from the COVID-19 pandemic.

AMAFI would like to point it out the following points.

1) The detrimental outcomes of the current regulation

AMAFI would like to point out that the MiFID II rules on research, which had neither been the subject of political discussions by the co-legislators nor been the subject of serious impact studies, have had a negative impact on the production of research in Europe, particularly for SMEs. It can be considered that this piece of legislation was not introduced in a proper manner.

AMAFI recognizes that the decline in SME coverage was a pre-existing trend to the implementation of MiFID II / MiFIR and that there are geographic divergences about the way investment research is produced and displayed in the UE.

It is assessed in many EU markets major markets that MiFID 2 has had a negative impact[1], in number and in quality on the SME coverage. It is not easy to give today quantitative evidence of the decline of the coverage.

[1] Fang, B., Hope, O.-K., Huang, Z. and Moldovan, R. (2019), 'The Effects of MiFID II on Sell-Side Analysts, Buy-Side Analysts, and Firms,' *Rotman School of Management Working Paper No. 3422155*, http://dx.doi.org/10.2139/ssrn.3422155, accessed 10 September 2019. See also for example the report issued by Assosim in June 2019 : 'The Financial Research in Italy under the MiFID II' . Admittedly, the Financial Conduct Authority (FCA) has published mid-September multi-firm review findings indicating the Markets in Financial Instruments Directive's (MiFID II) research unbundling rules have improved asset managers' accountability over costs, saving millions for investors (lien). It is surprising, however, that those findings, published by those who actively supported the new regime, has not been confirmed by these other studies, nor by the feeling of players in the French market : buy-side, sell side and small and mid-issuers. On this issue, see also Q 59 and 59.1 and the reasons why sponsored research is developing today.

On this topic, AMAFI performed, mid 2018 a study on the coverage of French shares by investment analysts between 2005 and 2017. This analysis highlights as well **several weaknesses** in the supply of financial analysis for small and medium capitalisations:

- **The supply is mainly provided by local players, while international players have disengaged from this market segment during the period of observation.**
- **The supply is more concentrated, creating greater risk of attrition, considering that the 3 more active providers represent 40% of the supply on the capitalisations smaller than 1 Bn €.**
- **The evolution of this supply appears to be largely dictated by a process of creative destruction leading to the emergence of new players replacing those who disappear rather than a mechanism of elasticity by virtue of which the « stable » players increase or decrease their coverage.**

In this environment, the new economic conditions introduced by MiFID II for the financial analysis business pose great risks for the prevalent « Schumpeterian » trend that has prevailed for the last decade. In this case, the disappearance of existing players would not be compensated by the emergence of new players, considering the growing weakening of their business model.

2) AMAFI welcomes the European Commission' proposal but would like to make the following comments

- Bundling threshold

AMAFI considers that the threshold of 1bn is the minimum one but that it could be extended to 5bn. Indeed portfolio management compagnies will most likely not opt for the bundling as it would not sufficiently cover mid caps and a lot of portfolios combine small and mid caps.

- Fixed income research

AMAFI does not understand the drafting of Article 13§11 (a). In practice it will be impossible to apply for fixed income instruments, since structurally the fixed income market is not based on execution fees. The compensation of the investment firm is included in the bid/ask spread. The spread is we cannot easily distinguish the share of the value attributed to research in the bid/ask spread. The spread depends on various factors such as market conditions, notation of the investors but never includes research value.

- Conditions to be met to benefit from the new bundling regime for SMEs

AMAFI considers that the conditions should be reduced and mitigated. In particular the investor should not have the possibility to disapprove the bundling of the financial research. A simple information to him should be required.

3) This proposal should be considered as a first step.

AMAFI considers that the EC proposal is welcome but is far from being sufficient considering the issue in stake. At least two other evolution should be considered.

- Issuer sponsored resarch

It be noted that the development of issuer-sponsored research is an important alternative way for SMEs research. That is why it is necessary to identify obstacles in MiFID II provisions of such development and modify accordingly, if relevant. Notably, it is crucial to be able to qualify issuer-sponsored research as “investment research” and not marketing communication (as per article 36 and 37 of MiFID II delegated regulation 2017/565) provided that the research provider strictly comply with the current MiFID II and MAR rules.

According to AMAFI's analysis:

- Issuer-sponsored research provided that the research provider strictly complies with the current MiFID II and MAR rules can be qualified as investment research (see our response to question 66). Notably, the nature "issuer-sponsored" of the research should be clearly disclosednder these conditions, if the issuer-sponsored research is made available at the same time to any investment firm wishing to receive it or to the general public, then it can be qualified as an acceptable minor non-monetary benefit.
- This does not mean that, as investment research, it should necessary be the case nor should it be qualified as an acceptable minor non-monetary benefit under all circumstances. It should be kept in mind that Issuers, in most cases only take in charge part of the production cost of the sponsored research. Against this background, most research producers specializing in Small & Midcaps would see their economic situation deteriorate further if they made their research freely available.
- Indeed, issuer sponsored research should be distributed through the same channels than non-sponsored research, as agreed between the producer and its clients (i.e., either the regime of acceptable minor non-monetary benefit as provided by article 12 **<u>OR</u>** the regime of research payment agreement as provided by article 13). It is worth mentioning as well that all clients are not subject to the ban of inducement and as such, outside the scope of article 12 and 13 of Delegated Directive

- <u>Free trial period</u>

The rules on free trial periods should be amended in order to:

- be implemented at the level of each asset class (equities, bonds, derivatives...)
- allow free trials for a period of 6 months in order to consider the pace at which the research recipients revise their purchasing policies for the services they subscribe to.