



MiFID II: Time to Begin Preparing for Change

“Happy New Year” as another acronym takes center stage in the European financial markets

It’s been 20 years since you first heard the term “RegFD” and 10 years ago “SOX” turned your legal team upside down. Well, this week you will start to hear more and more about MiFID II, which stands for the 2nd installment of the Markets in Financial Instruments Directive, a European law taking effect on January 3, 2018 that standardizes investment services regulations across all members of the European Union. The original MiFID law took effect in November 2007 and helped level the playing field among EU countries by organizing the internal controls of investment firms and how they conduct business with customers across Europe.

- [What’s new in MiFID II?](#)
- [U.S. gearing up for changes to adapt to MiFID II](#)
- [How will MiFID II affect my IR program?](#)

According to the ESMA (European Securities and Markets Authority):

“MiFID is a cornerstone of the EU’s regulation of financial markets seeking to improve their competitiveness by creating a single market for investment services and activities and to ensure a high degree of harmonized protection for investors in financial instruments.”

As an IR professional in Latin America, the adoption of MiFID over 10 years ago likely went unnoticed as it had no meaningful impact on your day to day activities. MiFID II, the updated and expanded version entering into effect today, will however begin to change the shape of some of the market dynamics you are used to, namely in the areas of broker-organized corporate access for the buy-side and the sell-side research business model.

What’s new in MiFID II?

The changes that resulted from MiFID in 2007 were more technical in nature; they focused on organizing the internal systems and controls of firms providing services in the investment business, i.e. investment banks, institutional investors, trading firms, brokers, etc. MiFID II is much more far-reaching in nature; its goal is to make the European markets more efficient through regulatory changes that will bring greater transparency from all participants, whether they are traders, fund managers or research analysts.

MiFID II has extended its scope to include additional financial securities and products such as derivatives, and operations such as dark pools and high-frequency trading. With cost transparency as a top priority, it is also forcing structural changes to the asset management industry that will ultimately lower fees in order to boost the role of asset managers throughout more European households.

The ESMA lists the most important improvements and necessary updates made to the original legislation through MiFID II as follows:

- New reporting requirements and tests will increase the amount of information available, and reduce the use of dark pools and OTC trading.
- The rules governing high-frequency trading will impose a strict set of organizational requirements on investment firms and trading venues, and the provisions regulating the non-discriminatory access to central counterparties (CCPs), trading venues and benchmarks are designed to increase competition.
- ***The protection of investors is strengthened through the introduction of new requirements on product governance and independent investment advice, the extension of existing rules to structured deposits, and the improvement of requirements in several areas, including on the responsibility of management bodies, inducements, information and reporting to clients, cross-selling, remuneration of staff, and best execution.***

The third bullet above describes the most relevant change to IR market dynamics as we know them, specifically pertaining to corporate access and sell-side research analysis. Up until now, *inducements* – such as sell-side research – were services bundled together with trading execution; for example, the banker would say to their client, “...my analyst will recommend what securities to buy and sell, and set up a meeting between you and the C-Suite behind those securities, as long as you execute those trades through my trading desk”. MiFID II, however, will force an unbundling of inducements and trading execution in Europe. As a result, services such as research and corporate access services provided in broker-sponsored non-deal roadshows will now become paid services contracted by the buy-side and accounted for as new revenue items for the banks that provide them.

In recent conversations with sell-side analysts in the U.S. on how they foresee this change will be executed and how they think these services will be priced, they mentioned that it will likely be determined by the size of the firm utilizing these services and the scope of the services they receive. For example, the largest institutional clients or ‘biggest accounts’ will negotiate an annual fee or price for ‘across the board’ access, i.e. corporate access, research reports, access to analysts, etc. Smaller accounts will likely pay a lower fee each month to receive a limited amount of services.

In an interview published in the Dec. 2017/Jan. 2018 issue of Bloomberg Markets Magazine, when questioned on the objectives of these changes and their implementation risk, Chairman of the ESMA, Steven Maijor commented that unbundling services will play a major role in making the asset management industry in the EU more competitive. He also pointed out that the largest asset managers were eager to implement this change and already began covering these expenses on their own account instead of billing the end consumer. He stated, “...with bundling, it’s unclear who pays for research. Who consumes the thing is different from who pays for it...If a portfolio manager can improve his performance by buying a certain amount of research, why wouldn’t he pay for it?” It will certainly be interesting to see how these changes evolve and how they affect the sell-side dynamic that is cornerstone to an active IR program.



U.S. gearing up for changes to adapt to MiFID II

While MiFID and MiFID II are European regulations, their adoption will affect any financial firm conducting business in Europe. For example, in terms of unbundling, it is against current U.S. regulation for a broker to charge for research. In October 2017, the SEC stated that it would give firms a 30-month grace period to charge for research with no action against them. This move was intended to prevent major disruptions and allow U.S. firms to continue to provide research to their European customers until a more definitive stance is taken on whether to adopt the changes proposed in MiFID II. There are several players in the U.S. lobbying to adopt unbundling as it provides more transparency on costs and forces improvements in the research offering. During this 2.5 year time frame, the U.S. market will be able to monitor the impact of these changes in Europe and more effectively decide its next moves.

How will MiFID II affect my IR program?

While many of the changes that will result from MiFID II are aimed at banks and financial institutions and will not affect your IR program directly, the unbundling of inducements will certainly alter the current dynamic between issuers and the sell-side. Gone will be the days of broker-sponsored non-deal roadshows for issuers just because they have a good relationship with the bank. Once these services are monetized, they will be based on buy-side demand. Investors will still seek good investment ideas from the expert analysts, but these services will become much more focused and revenue driven.

Therefore, issuers will need to assess their position within the capital markets units of the various banks that have provided them research coverage up to now. Some IROs may have to adjust their IR programs and dedicate more time and resources towards direct marketing to the buy-side. Coverage may also drop for less liquid names, which will result in lower visibility. Thus, paid research services for added coverage may be necessary, as well as direct communications with investors in the form of material news, company organized one-on-one meetings and group events, in order to keep your company on their radar.

We expect that over the next year, research department heads and analysts in the region will be discussing how these changes will affect their business and how they will work with various issuers going forward. In the meantime, we strongly recommend communicating these changes internally to your Management Team and Board of Directors. Their understanding of unbundling and how it may affect your IR department will be critical to gaining their support for any necessary adjustments to your program. The SEC's 30-month reprieve puts us into some form of adoption by the first quarter of 2020, but it is never too early to prepare for the changes that inevitably lie ahead.

For more information on how i-advize Corporate Communications can help you adapt your IR program to MiFID II changes, please contact us at:



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