MiFID II: A CHECK ON REALITY

Introduction

Following the global financial crisis, the European Commission produced plans to review the Markets in Financial Instruments Directive (MiFID) framework, a cornerstone for the regulation of European financial services. The second casting of the legislation, known as MiFID II, comes into effect on 3 January 2018 and is expected to have significant impacts not only for European capital markets, but potentially the global investment landscape.

In response to the evolving regulatory landscape and with less than a year until MiFID II is implemented, Ipreo examines perspectives respectively from the buy side, banks, and corporate issuers in order to compare the facts and perceptions of MiFID II from every side of the investment triangle.

The Facts of MiFID II

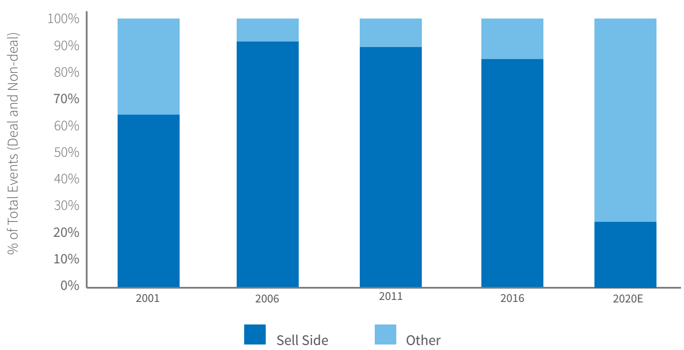
MiFID II aims to overhaul, strengthen, and extend the existing regulatory system for financial markets in the EU by creating:

- Increased transparency of markets
- Shift in trading towards more structured marketplaces
- Lower cost market data
- Improved best execution
- Orderly trading behaviour within markets
- Explicit costs of trading and research process (trade execution, research, and management access)

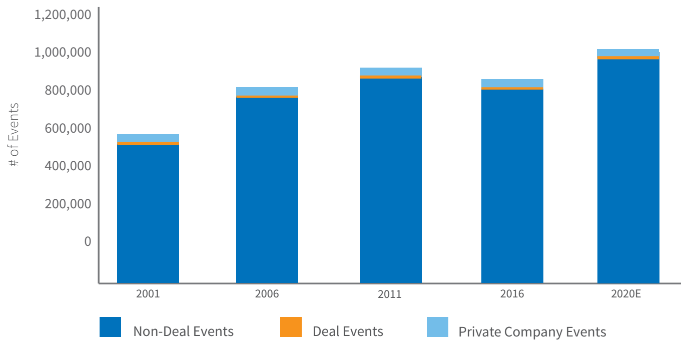
Q: Based on these facts, how will the research and corporate access landscape change as a result?

- The price transparency and reduction in payments created by MiFID II may lead to margin compression for sell-side brokers who have traditionally provided research and hosted a majority of meetings
- As a result, the sell side will have to place greater consideration on its allocation of resources and choice of coverage
- Brokers may focus their activities around the most profitable events for top-tier clients, leaving smaller stocks and/or less popular sectors with less coverage and marketing
- In response to these changes, there is an expectation that IR will need to undertake more of these activities themselves (both marketing and event execution)

REGULATION THAT FLIPS THE MARKET*



RESILIENT GROWTH IN DEMAND FOR EVENTS*

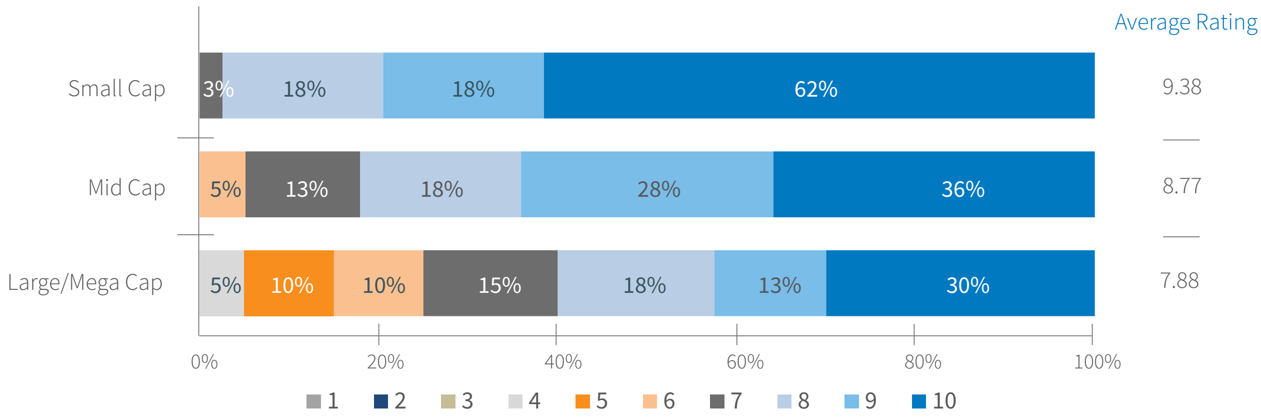


*Graph Source: The World Bank, Ipreo Data, and IR Magazine Data

Market Perceptions of MiFID II

In May and June 2017, Ipreo's Perception Analytics team held in-depth interviews with over 50 institutional investors across 13 countries and whose firms manage almost $1.5T in combined equity assets. The survey population of portfolio managers and analysts provided feedback on three key questions facing corporate issuers and their IR teams in anticipation of the MiFID II roll-out.

Q: What is the importance of meeting with senior management teams?*



Graph Source: Ipreo Data

*10=Highest Importance

- Based on the discrepancy in average ratings, investors generally place greater importance on meeting with the senior management of small- and mid-cap companies because:
  - These CEOs and CFOs are typically less well-known figures
  - There tends to be less publicly available information and less sell-side coverage
  - There are likely higher hurdles of trust and credibility when investing in smaller companies
- However, many participants acknowledge that meeting senior management is an integral part of their due diligence processes, regardless of market cap. C-suite engagement is a means to build on their research, establish a rapport with senior leadership, and hear the strategy directly from the CEO or CFO

"The smaller the company, the more important it is to meet with senior management as there is less coverage and publicly available information."

European Mutual Fund ($25 -50B EAUM)

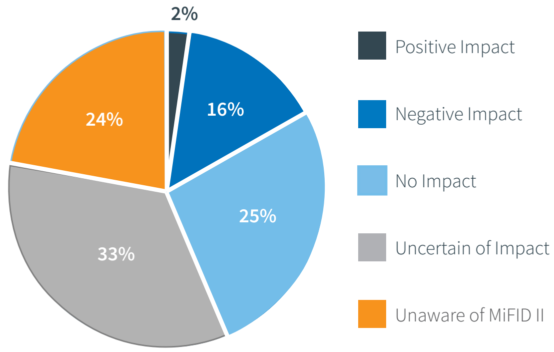
"I want to get a grip of who these management teams are that I am giving money to. It does not matter how big the company is; I still need to build that trust."

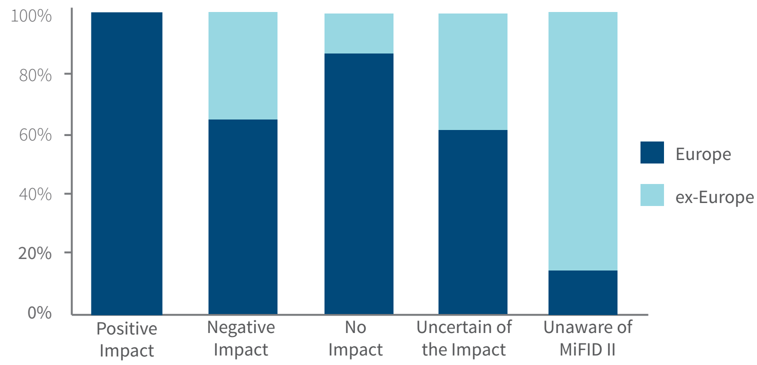
European Mutual Fund (<$10B EAUM)

"I never invest in a company without meeting management. We meet with small-cap companies more often because there is information that we get from those meetings that we cannot get otherwise."

European Hedge Fund (<$10B EAUM)

Q: What are the expected impacts of MiFID II?*





*Graph Source: Ipreo Data

- Generally speaking, buy-side focus on MiFID II is surprisingly low as:
  - Many PMs/analysts are simply not actively thinking about how it will impact their workflow
  - Their compliance teams are still in the process of understanding and determining expected firm-wide changes
  - There is still uncertainty about what the roll-out will actually look like
- However, there is broad recognition that buy-side relationships with the sell side will likely evolve and become more complicated under the new regulatory environment, and some foresee detrimental effects in terms of:
  - Diminished reliance on brokers for corporate access (shift to direct outreach from IR, third-party intermediaries, or in-house coordinator)
  - Less broker coverage of small- and mid-caps
  - More difficulty in accessing non-portfolio companies
  - More pressure on IR teams to maintain management visibility
- Some interesting findings surface when analysing the feedback by region and EAUM:
  - Many investors domiciled outside of Europe are completely unaware of MiFID II, even though the EU regulation may have implications globally
  - Most of the neutral sentiment is driven by participants at firms with >$25B in total EAUM, suggesting that these investors are less concerned about negative ramifications on research and corporate access due to their scale and existing market relationships

> "I expect the investment universe that the sell side is willing to cover to contract under this new regulation, so there are a lot of small-cap companies that are not going to be covered as closely as they are today."

European Hedge Fund (<$10B EAUM)

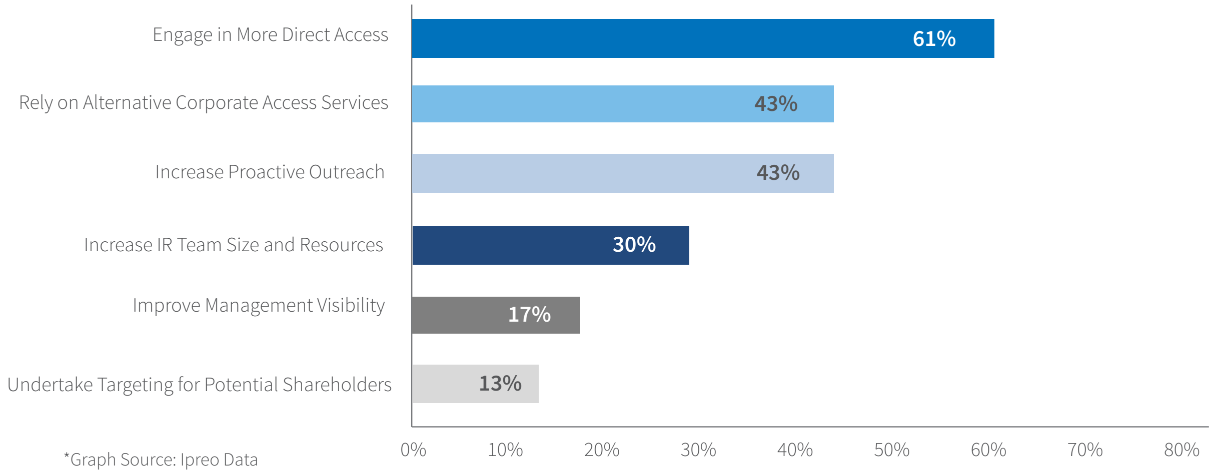
> "I do not expect a significantly negative impact on our ability to get access, but it will impact how we go about accessing management. It may be that I can no longer just call a broker and tell him to set up a meeting. We tend to use brokers for companies that we do not own and have not owned in the past."

North American Mutual Fund (>$50B EAUM)

> "From what I understand, there will be a de-bundling of commission payments from trading and research. Asset managers will have to pick expenses around research. There will be a far greater impact on sell-side research. There may be a paring-down of firms to a smaller subset who will provide best-in-class research that the market will be willing to pay for."

European Mutual Fund (<$10B EAUM)

Q: What are your expectations for issuers and their IR teams in a post-MiFID II environment?*



*Graph Source: Ipreo Data

- Against the backdrop of MiFID II, IR teams are encouraged to:
  - Increase direct engagement and proactive outreach with investors
  - Utilize external tools and services that help prioritise, organise, and prepare for roadshows and company-hosted investor events
  - Maintain a high level of management visibility and information flow to counter any reduction in coverage or broker-facilitated corporate access
  - Undertake institutional targeting analyses to exercise greater control of communications with non-holders

- With the expected increase of responsibilities falling onto the IR function, respondents expect for companies to grow their IR teams in order to deal with increased volume of requests and ensure that outreach remains unaffected

"It is a new situation and a lot of work that is done by entire industries is falling back into the IR department. IR teams will be swamped with requests. It would be poor corporate governance if companies are not prepared. Companies need to expand their IR teams to deal with MiFID II."

European Mutual Fund (<$10B EAUM)

"I hope the IR teams do not go about business in the same way. With a greater degree of concentration in providers of research, you wouldn't want to see potential shareholders' access to your company limited because they have not signed on with one of the bigger houses. The IR team needs to make corporate access easier and more welcoming for investors."

European Mutual Fund (<$10B EAUM)

"Adding events like additional Investor Days to generate management access could add a lot of value once MiFID goes into effect. Management teams also have to devote more time directly to the buy side following events, rather than going to a broker. Site visits and HQ visits that issuers set up without brokers will be important."

North American Pension Fund ($5-24.9B EAUM)

Throughout Ipreo's conversations with corporate issuers, some IR teams are already beginning to prepare for a drastically different landscape post-MiFID II. However, there is little consistency in their approach or action plans as they echo the buy side's uncertainty. Below are a few excerpts of those discussions:

"I spoke with a former analyst who was laid off in a 'strategic realignment.' It sounds like the bank is getting out of research due to new rules that will be coming into effect that apparently will change the whole pay structure for sell-side analysts."

VP of IR, Large-cap North American Company

"It will be difficult for small- and mid-caps to organize roadshows should brokers stop facilitating those meetings. A number of small caps do not even have proper IR teams. Issuers may have to increase the size of their IR teams post MiFID II and conduct targeting exercises to diversify their shareholder bases."

Head of IR, Mid-cap European Company

"It is difficult for us to organize roadshows since we do not have the same structure as brokers. Issuers do not have the extensive network of institutional contacts like brokers. If we have to pay for roadshows, we will need to find an alternative."

Head of IR, Small-cap European Company

Preparing for Uncertainty

In conclusion, while MiFID II may not create sweeping changes overnight, Ipreo's analysis reveals that an evolution in market relationships and workflow is likely to take place, which will mark a new era of uncertainty. In light of this, how does the market (from all perspectives – buy side, sell side, corporate issuers) prepare accordingly?

01 BUY SIDE:

Prepare to be accountable – what services are consumed, at what price, paid for via what funds, and to prove that behaviour cannot be considered an inducement. We already see some larger and forward-thinking funds looking to use technology to source, track, and pay for services they consume. Investment managers outside of Europe will have to adopt MiFID II standards to receive research and participate in broker-sponsored engagements.

02 BROKERS:

Prepare for price transparency and a reduction in margin; the change will not come overnight but brokers will look to focus their activities on fewer, higher value activities. We already see effort and resources being put towards a bifurcation of client lists and the creation of service layers/levels.

03 ISSUERS:

Prepare for a reduction in 'free' service provision from brokers, in some areas of the market. There is an expectation that MiFID II will expand the gap between large- and small-cap companies as broker focus continues to favour widely held companies. For those affected, IR will need to be more self-reliant for research provision and corporate access execution in order to meet the buy side's expectations. Corporate issuers outside of Europe should prepare to face a similar phenomenon when engaging with brokers and investors as the effects of MiFID II ripple across the global investment community.

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We work as an extension of our clients' Investor Relations team

With dedicated analysts based in New York, London, and Cape Town, Ipreo's Perception Analytics team partners with corporate clients to develop actionable strategies that shape investor perceptions, differentiate their companies as investment opportunities, and help to attract global capital.

For more information about the findings in this report and Ipreo's Perception Analytics:

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