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MIFID II: A NEW PARADIGM FOR INVESTMENT RESEARCH

Investor Perspectives on Research Costs and Procurement

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CONTENTS

EXECUTIVE SUMMARY

The provision of investment research is set to change dramatically in Europe. The revised Markets in Financial Instruments Directive (MiFID II), which comes into effect on 3 January 2018, will deliver sweeping reforms to financial markets and business practices. It is set to disrupt the production and distribution of investment research.

Under MiFID II, brokers will have to establish a price for investment research separately from execution services. The rules apply to all asset classes. Asset management firms will have to develop research budgets, and either pass the cost of research on to clients via pre-agreed research payment accounts or absorb the cost of research themselves (i.e., against the firm's profit and loss).

To help inform the current state of the market for investment research, CFA Institute conducted a survey of its European members in September 2017. The survey sought to understand the expectations of buy-side professionals regarding pricing of research for different asset classes, the allocation of costs, and other related issues. The methodology, demographics, and results are presented in sections 3 and 4 of this report.

SUMMARY FINDINGS:

- **Most asset management firms intend to absorb research costs rather than charge clients. Yet the survey findings also highlight a disparity between large and small firms, with large asset managers more likely (and more able) to absorb research costs than small asset managers, suggesting a competitive advantage for larger firms.**

- **A clear majority of survey respondents (78%) expect to source relatively less research from the sell-side under MiFID II, with the corollary that investment management firms are likely to source more research in-house, a view expressed by 44% of respondents (a plurality).**

- **Perceptions of the cost of research varied both within and across asset classes. The median value of the annual expected cost of equity research was 10 basis points, which equates to €1 million per annum on a notional €1 billion assets under management (AUM). The middle 50% of the distribution of responses for the expected cost of equity research ranged from 5 basis points to 20 basis points. For fixed income, currencies, and commodities (FICC) research, the median expected cost was 3.5 basis points, equating to €350,000 per annum on a notional AUM of €1 billion. The middle 50% of the distribution of responses ranged from 1 basis point to 10 basis points.**

- **The variance of responses is likely a function of the level of uncertainty over pricing, with pricing negotiations ongoing between investment management firms and research providers. Moreover, it also reflects the diversity of investment strategies within the respective asset classes. For example, domestic or large-cap equities research may be expected to price towards the lower end of the above range, with emerging markets or small-cap equity research more likely to price towards the higher end of the range. Similar considerations apply to the range of cost estimates for FICC research.**

- **Views were mixed as to whether aggregate research and execution costs would rise or fall. Respondents with fixed income as their primary investment practice are far more likely to agree that aggregate costs will increase than respondents with equities as their primary investment practice. This implies that investment professionals do not believe fixed-income spreads (execution costs) will go down as a result of broker-dealers charging separately for fixed-income research.**

CFA Institute supports the objectives of these reforms, which are to remove potential conflicts of interest between asset managers and their clients when transacting with brokers, and to deliver a more transparent, competitive, and efficient market for research. But the rules are not a panacea. Investment professionals responding to our survey expressed concerns over unintended consequences, including a decrease in the availability of research and a reduction in research coverage.

Whilst the ultimate outcomes of MiFID II on firms, markets, and investors are as yet unknown, it is clear that the rules will have a significant impact on business operations. With investment professionals expecting reduced consumption of sell-side research, investment banks must seek to re-focus their research offerings. Independent research providers may compete on a more even playing field, whereby research consumers can compare price and quality across products and service levels. Opportunities to grow market share will arise for firms that can differentiate their offerings and deliver higher value-adding insights.

If these changes materialise, investors stand to benefit from an increase in research quality and thus more informed investment decision-making. The transition to the new paradigm may be disruptive, but it promises to deliver a more efficient market in the long run.

INVESTMENT PROFESSIONALS EXPRESSED CONCERNS OVER UNINTENDED CONSEQUENCES OF MIFID II, INCLUDING A DECREASE IN THE AVAILABILITY OF RESEARCH

1. INTRODUCTION

The provision of investment research is set to change dramatically in Europe under the revised Markets in Financial Instruments Directive (MiFID II). The traditional business model of brokers providing bundled research and execution services to asset managers will end. Investment banks and other research providers will have to establish a price for research and charge clients separately for those services. Asset managers will have to develop research budgets and determine how to allocate the costs of research.

Explicit payment for research is set to shake up the investment industry on both the buy-side and sell-side.

MiFID II, effective from 3 January 2018, aims to reform market structures, bring more transparency to the trading of financial instruments, and strengthen investor protection. The portfolio management 'inducements' rules are particularly significant for investment management firms and professionals. These rules govern the provision of research and other non-monetary benefits, and aim to address potential conflicts of interest between asset managers and their clients when transacting with brokers.

Under the rules, asset managers must create research budgets and either charge the costs of research to clients via pre-agreed Research Payment Accounts (RPAs), or absorb the cost of research themselves (i.e., against the firm's profit and loss). The rules apply to all asset classes.

EXPLICIT PAYMENT FOR RESEARCH IS SET TO SHAKE UP THE INVESTMENT INDUSTRY ON BOTH THE BUY-SIDE AND SELL-SIDE

On the sell-side, brokers must separate research from execution services. But how much brokers charge for research will depend on several factors.

First, the value of research for the user typically varies according to the asset class being invested in, and the type of investment strategy pursued—research costs for fixed-income will differ from equities, for example. Moreover, unlike equities, fixed income securities are not commission based; instead, dealers are compensated for executing trades via the bid-offer spread. Further, research coverage of the most widely traded issuances is far more extensive than for less liquid securities or the securities of smaller companies, which may further differentiate research pricing.

A second factor that may affect how much brokers charge for research is the size of the asset manager's research budget, itself a function of the size of the firm and its client base. A third, related, factor is whether the firm charges research to clients or against its own account. This decision may influence the size of the research budget because when firms charge clients (via RPAs), the agreement of clients must be obtained in advance, which could lead to a reappraisal of the level of funding in the RPA.

A fourth (interrelated) factor is the willingness and ability of firms to absorb research costs. For example, large firms with in-house research capabilities, and large client bases, may be more able to absorb research costs than smaller firms. In turn, these firms will likely have greater bargaining power with research providers than small firms.

Consequently, establishing a price for research, developing research budgets, and allocating costs are complex considerations.

To help inform the current state of the market for investment research, CFA Institute conducted a survey of its European members in September 2017. The survey sought to understand the expectations of buy-side professionals regarding pricing of research for different asset classes, whether firms expect to absorb research costs or charge clients, and other related issues.

The results are presented in this paper (see section 4) and highlight that most respondents expect firms to absorb research costs, but there is significant variation in expected research costs. Generally, the results also vary across asset classes and across firm size.

Whilst the ultimate outcomes of MiFID II on firms, markets, and investors are as yet unknown, it is clear that the rules will have a significant impact on business operations.

Throughout the report, some charts do not add up to 100% due to rounding.

2. REGULATORY BACKGROUND

Passed into law in June 2014, MiFID II forms the centrepiece of European securities markets legislation.[1] MiFID II sets new rules for the structure of markets and the trading of financial instruments, and prescribes conduct of business standards for the provision of investment products and services. It is a comprehensive legislative package (comprising a directive and a regulation) that affects investment firms, market participants, and investors.

A central theme of the MiFID II reforms is increased transparency. Whilst MiFID I focused on opening up markets to greater competition, MiFID II seeks to shine greater light on business practices, and provide more price transparency to investors across all asset classes through extensive market data reporting requirements.

The inducements rules aim to deliver more transparency over costs and deliver better outcomes for investors by eliminating potential conflicts of interest in the procurement of research, as well as in the provision of financial advice.

Portfolio management inducements arise when an asset manager receives bundled execution and research services from a broker (an arrangement commonly referred to as soft commissions or soft dollars). The provision of supplementary products or services by the executing broker—such as research reports, analyst calls, corporate access, or other non-monetary benefits—can induce the asset manager to route trades to that broker (in order to secure those services), with the potential to either trade more often than is appropriate for the client, or to preclude the use of other brokers who may provide more favourable execution services.

Consequently, the presence of inducements may compromise the asset manager's obligation to obtain best execution for the client, and may result in investors incurring higher (bundled) transaction costs than appropriate. Further, soft commission arrangements are susceptible to abuses if those commissions (deducted from the value of the client's investment) are used to secure services that primarily benefit the asset manager as opposed to the investor.[2]

The ban on portfolio management inducements under MiFID II is therefore designed to remove the aforementioned conflicts of interest. By requiring brokers to charge separately for research, policymakers aim to deliver more value for investors via more efficient research budgeting processes on the part of asset managers, as well as increasing transparency and reducing costs.

The technical standards developed by the European Securities and Markets Authority (ESMA) in 2015 specify how the rules should be interpreted and implemented. ESMA, alongside other national regulators, have since published a series of guidance documents to assist firms. The guidelines specify what constitutes 'research'. Research would include, for example, substantive analysis that provides original investment-specific insights (including written material and calls with analysts), but excludes generic short-term market commentary or economic statistics that are widely publicised. The guidelines further specify that it is the obligation of the investment firm receiving the research to determine its materiality and relevance to the investment strategy; 'minor non-monetary benefits' (such as the aforementioned generic market commentary) would not be considered inducements.

The portfolio management inducements rules are the latest attempt by policymakers to improve efficiency in the market for research. They follow earlier attempts by regulators, most notably in the United Kingdom, to restrict the scope of soft commission arrangements and drive more accountability. In the case of equities, the UK regulatory framework for dealing commission already enables a demarcation of costs between execution services and research via the use of Commission Sharing Agreements (CSAs). This mechanism allows brokers to collect a single commission, but place the allocated non-execution element of that commission into a CSA account, which can then be used by the asset manager to direct payments to any research provider. However, there is no equivalent framework for non-equities, such as fixed income, in which executing brokers are remunerated by the dealing spread as opposed to a commission.

The inducements rules under MiFID II not only necessitate a change to the existing CSA model by forcing a more explicit separation of payments, but their extension to all asset classes necessitates an entirely new regime for non-equity research procurement.

Although the objectives of MiFID II are clear, there has been much contention among stakeholders over whether the rules will deliver the intended benefits. If aggregate research spending is cut, for example, possible unintended consequences include a reduction in analyst numbers and a corresponding reduction in research coverage, particularly for smaller companies. On the other hand, it is arguable that there is already an under-supply of research on smaller companies and an over-supply of research coverage of the most liquid issuances, implying an inefficient market. If so, the disruption brought by MiFID II may help address these imbalances.

Ultimately, the extent to which these effects materialise will only likely become clear several months or years after the implementation of MiFID II.

The MiFID II rules also conflict with securities laws in other regions. Soft commissions are typically permitted in other markets, including the United States, where explicit payment for research is otherwise prohibited for broker-dealers. To address this problem, in October 2017, the U.S. Securities and Exchange Commission (SEC) issued a series of 'no-action' letters to permit US broker-dealers to provide separately paid-for research services for European clients, alongside existing bundled commission arrangements for US clients, for a period of 30 months. The SEC announced it will study the effects of MiFID II and consider whether any permanent changes to its securities laws are appropriate. These developments underscore the extra-territorial impact of MiFID II and the challenges it creates for securities markets regulation in third countries.

For firms operating a global business model, navigating the uneven regulatory landscape will be crucial if process efficiencies are to be achieved, and if clients are to be served according to similar standards across regions.

[1] For a comprehensive overview of MiFID II, see CFA Institute Policy Brief, 'Markets in Financial Instruments Directive II: Implementing the Legislation', available at www.cfainstitute.org/learning/products/publications/contributed/Pages/policy_brief__markets_in_financial_instruments_directive_ii___implementing_the_legislation.aspx

[2] To address these issues, CFA Institute published its Soft Dollar Standards in 2004. The standards are available at www.cfapubs.org/toc/ccb/2004/2004/1

3. SURVEY METHODOLOGY AND DEMOGRAPHICS

To evaluate the state of the market for research, CFA Institute conducted a survey of its European members in September 2017. The survey was sent to investment professionals working in relevant job functions.[3] The survey was also sent to a sample of asset management firms, including C-suite contacts among the largest 400 asset managers in Europe.

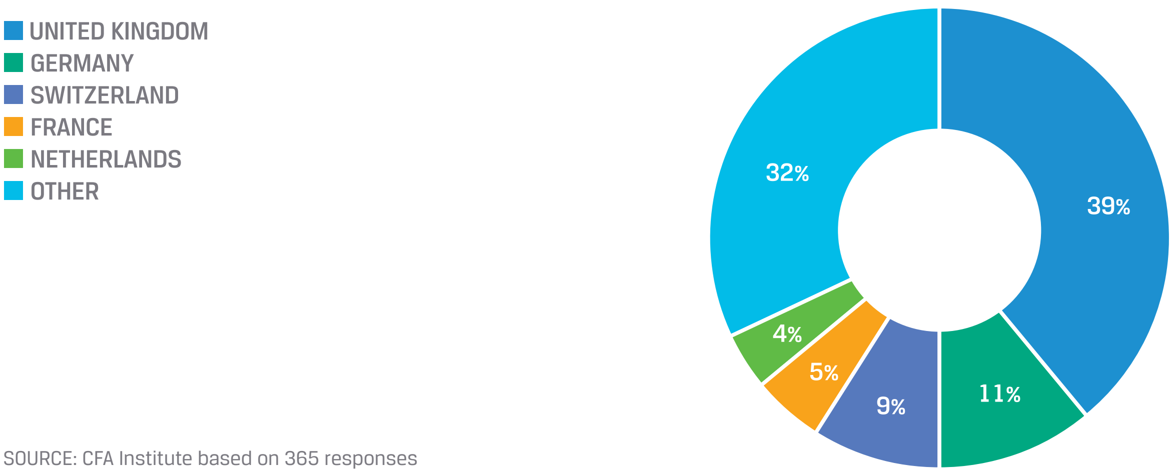
In total, 12,671 invitations were sent to members and external contacts, and 705 responses were received. Two screening questions were then applied to ensure that only investment professionals working on the buy-side and who are involved in using, producing, or procuring investment research were eligible to complete the survey.

Following this screening process, a final set of up to 365 valid responses were received. The response rate was 2.9% and the margin of error ±4.5%. The respondents came from 330 firms and 28 different European countries.

As illustrated in **Figure 1**, five countries account for 68% of the respondents.

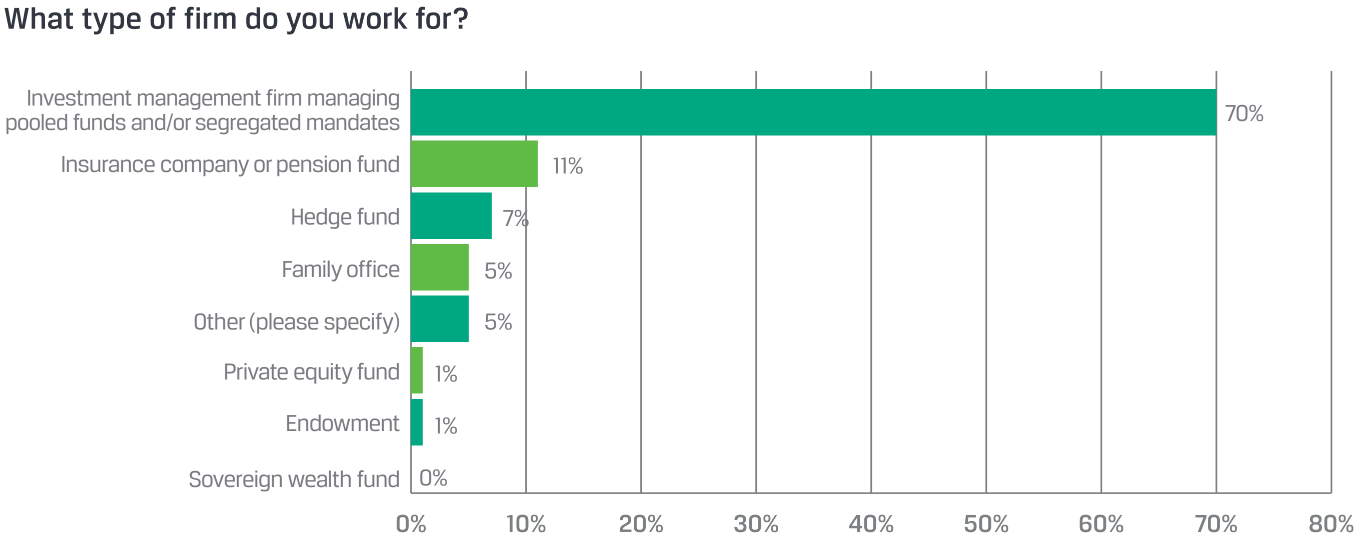
Firm demographics are illustrated in **Figure 2**. Seventy percent of respondents work in traditional investment management firms managing pooled funds and/or segregated mandates. Respondents answering 'other' typically work for private banks or wealth managers.

FIGURE 1: **RESPONDENT PROFILE BY GEOGRAPHY**



SOURCE: CFA Institute based on 365 responses

FIGURE 2: **RESPONDENT PROFILE BY TYPE OF FIRM**



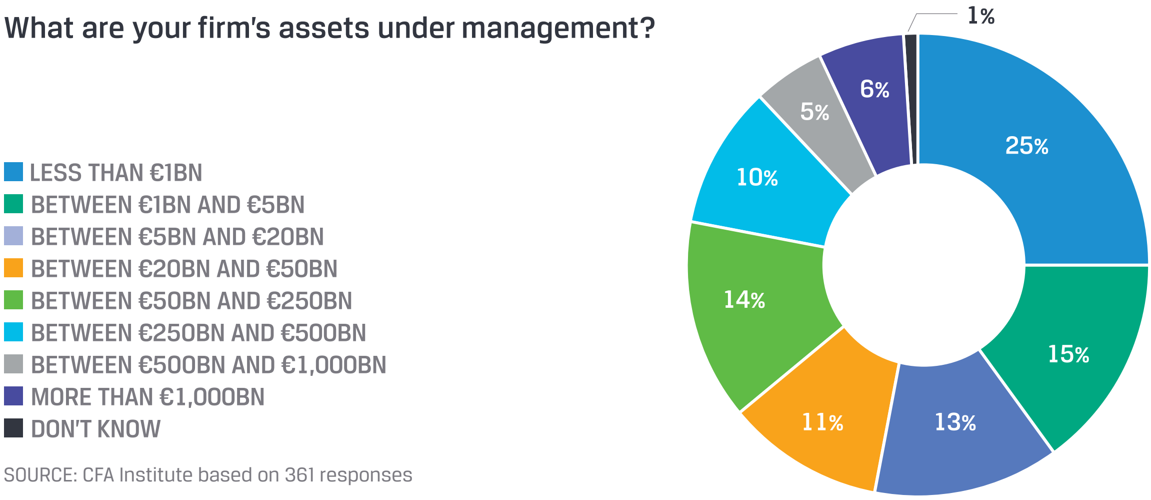
SOURCE: CFA Institute based on 365 responses

The assets under management (AUM) of respondents' firms are shown in **Figure 3**. It illustrates that firms of all sizes are represented in the results. Responses were subsequently grouped into four AUM categories, with a similar mass of respondents in each category, to enable statistically significant comparisons across firm size. The four AUM groupings are shown in **Figure 4**.

RESPONDENTS FROM 330 FIRMS AND 28 DIFFERENT EUROPEAN COUNTRIES WERE REPRESENTED IN THE SURVEY

FIGURE 3: **RESPONDENT PROFILE BY FIRM SIZE (AUM)**

What are your firm's assets under management?



SOURCE: CFA Institute based on 361 responses

FIGURE 4: **RESPONDENT PROFILE BY FIRM SIZE (AUM, GROUPED)**

SOURCE: CFA Institute based on 361 responses

[3] Selected job functions included: broker, chief administrative officer, chief operating officer, chief executive officer, chief investment officer, credit analyst, equity sales, fixed-income sales, institutional sales, investment banking analyst, operations, other chief executive, portfolio manager, research analyst, trader.

4. RESULTS

To begin with, survey respondents were asked whether they expect their firms to pay for research, or charge clients via RPAs.

As shown in **Figure 5**, 53% of respondents indicated that they expect their firm to absorb the cost of research, compared with only 15% who expect their firms to charge clients for research. A further 12% of respondents expected a mixed attribution (such as, for example, absorbing the cost of fixed income research but charging clients for equity research), whilst 21% were still unsure.

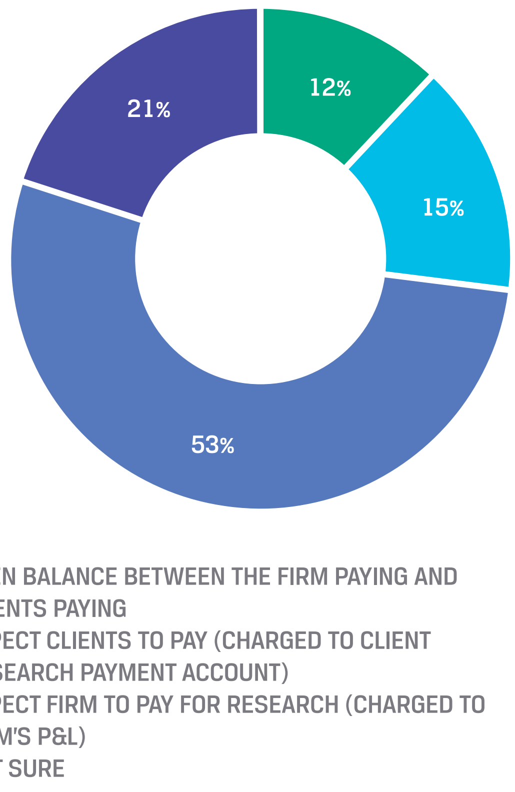
These results corroborate the view that, increasingly, asset managers are opting to pay for research themselves. There are several possible explanatory factors for this trend. First, given that several large firms have announced that they will not charge clients for research,[4] competitive pressures may simply force other firms to follow suit. Second, the decision to absorb research costs at the firm level could be partly attributable to the fact that establishing RPAs and obtaining client agreement over the budget is more operationally burdensome. Finally, booking the research expense against the firm's profit and loss may also confer certain tax advantages.

The proportion of respondents expecting their firm to absorb the cost of research also increases with the respondent firm's AUM, as illustrated in **Figure 6**. Sixty-seven percent of respondents with AUM greater than €250 billion expected their firms to absorb the cost of research; in comparison, only 42% of respondents from firms with less than €1 billion under management expected their firms to absorb research costs. There is also more uncertainty among small firms: 25% of respondents from firms with less than €1 billion under management are still unsure about their charging policy, whereas only 16% of respondents from firms with greater than €250 billion under management are unsure.

Overall, these results indicate that larger firms are more willing and able to absorb research costs than smaller firms, suggesting a potential competitive disadvantage for smaller firms. Over time, this could potentially divert more investment mandates towards larger managers, or drive more consolidation in the industry.

FIGURE 5: **EXPECTED ATTRIBUTION OF THE COST OF RESEARCH UNDER MIFID II**

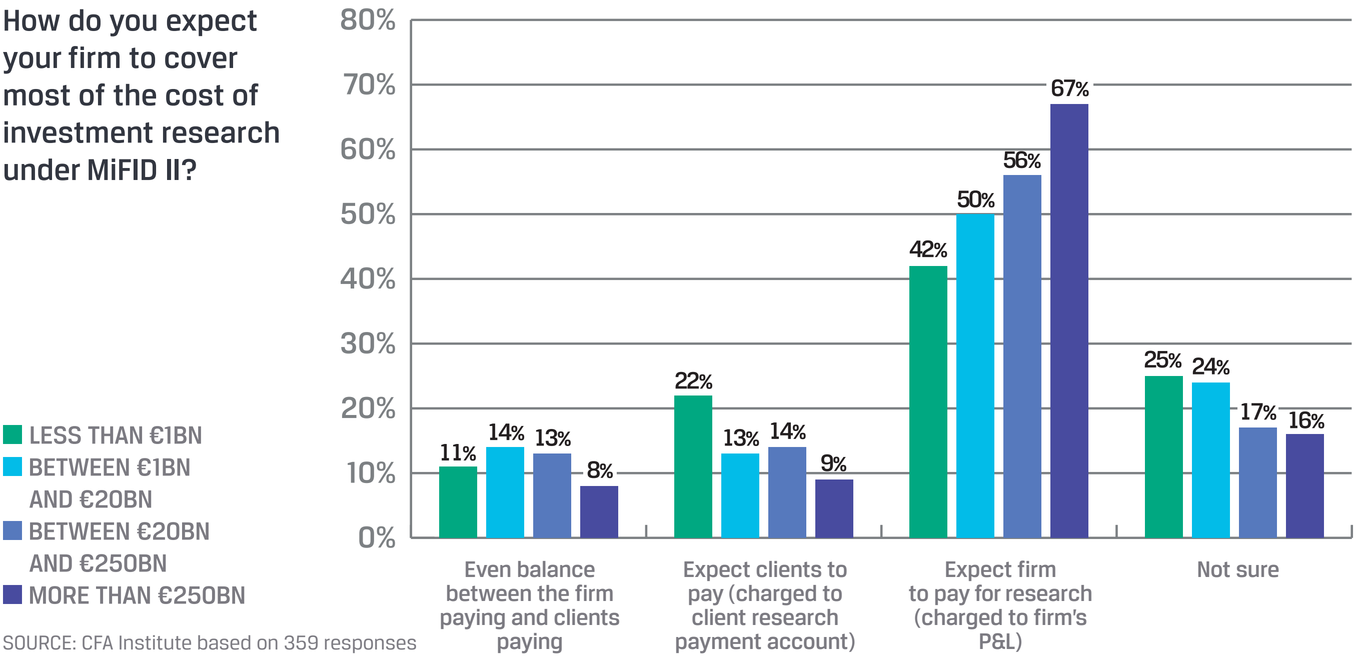
How do you expect your firm to cover most of the cost of investment research under MiFID II?



SOURCE: CFA Institute based on 359 responses

[4] A list of firms that have announced their charging policy is published in the *Financial Times*. See www.ft.com/mifid

FIGURE 6: **EXPECTED ATTRIBUTION OF RESEARCH COSTS UNDER MIFID II, BY AUM**



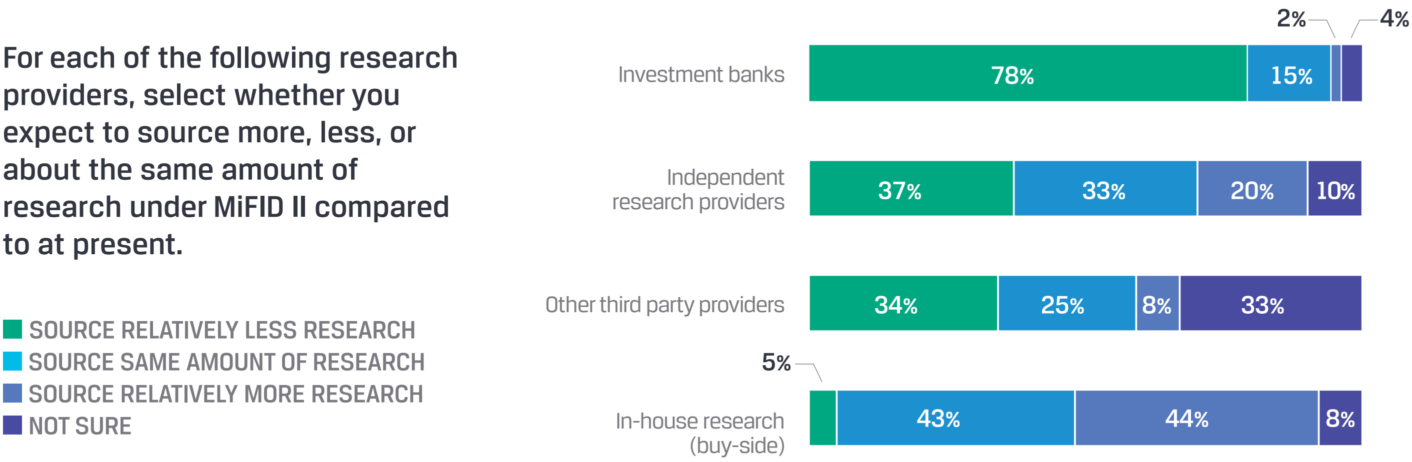
SOURCE: CFA Institute based on 359 responses

Next, the survey sought to understand if investment professionals expect to source relatively more, or less, research from different providers under MiFID II. Any changes in where research is sourced from may have implications for where analysts are employed, as well as for the aggregate number of analysts employed.

As illustrated in **Figure 7**, investment banks are expected to lose out, with 78% of respondents expecting to source relatively less research from the sell-side. The corollary is that investment management firms are likely to source more research in-house, a view expressed by 44% of respondents (a plurality). The impact on independent research providers and other third-party providers is expected to be more mixed, although around one-third of respondents still expect to source less research from both types of providers.

78% OF BUY-SIDE PROFESSIONALS INDICATED THAT THEY EXPECT TO SOURCE LESS RESEARCH FROM THE SELL-SIDE

FIGURE 7: **IMPACT ON RESEARCH PROVIDERS**



SOURCE: CFA Institute based on 364 responses

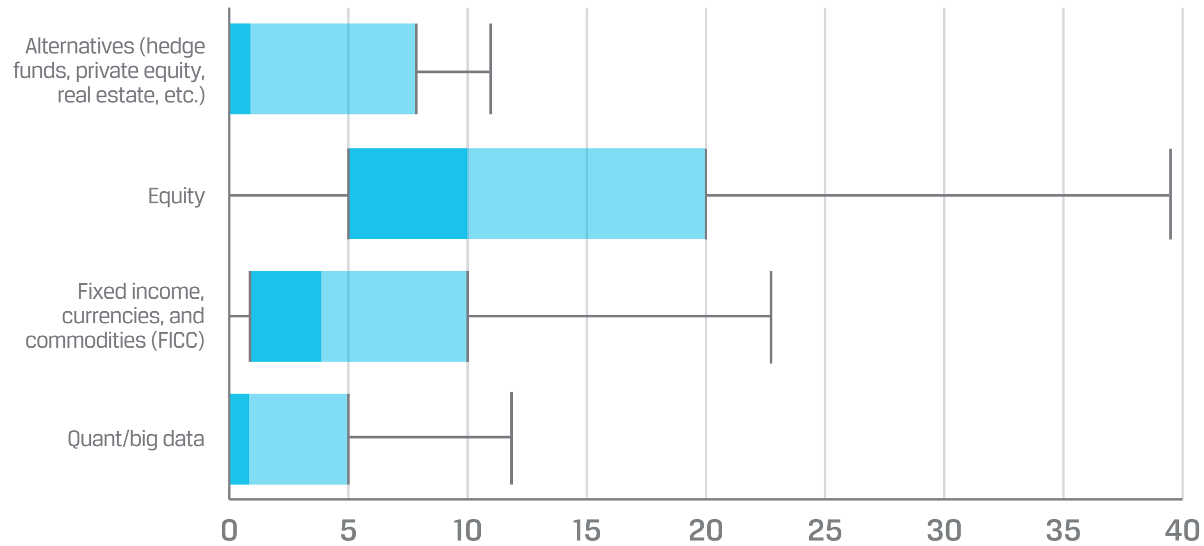
The survey next asked respondents how much they expect to pay annually for external investment research, expressed in basis points on AUM. Responses varied widely both within and across asset classes, highlighting the lack of industry consensus over what different research products should cost. Responses did not vary materially by firm size.

The results are presented in **Figure 8**. It captures the average value of the expected cost of research by asset class, as well as the range of responses.

For each asset class, the blue box represents the middle 50% of the distribution of responses; the lower end of the box represents the 25th percentile, and the upper end of the box the 75th percentile. The median (average) value, or 50th percentile, is represented by the line separating the shading. Points outside the whiskers are outliers.

FIGURE 8: **EXPECTED ANNUAL COST OF RESEARCH UNDER MIFID II**

For each of the following asset classes or sectors, how much do you expect external investment research to cost your firm annually under MiFID II? (Basis points)



SOURCE: CFA Institute based on 213 responses

As **Figure 8** illustrates, the median value of the annual expected cost of equity research was 10 basis points. This equates to €1 million per annum on a notional €1 billion AUM. The middle 50% of the distribution of responses for the cost of equity research ranged from 5 basis points to 20 basis points, with the lower 25% of the box (dark blue), or second quartile, ranging from 5 to 10 basis points, and the upper 25% (light blue), or third quartile, ranging from 10 to 20 basis points. The variance of responses is likely a function of the level of uncertainty over pricing, as well as the diversity of equity investment strategies. For example, one might expect a relatively low research cost (e.g., towards the 25th percentile or lower) for a domestic large-cap equity strategy, but a relatively high cost (e.g., towards the 75th percentile) for a small-cap or emerging markets equity strategy.

The expected cost of FICC research was lower than for equity research, with a median expected cost of 3.5 basis points—equating to €350,000 per annum on a notional AUM of €1 billion. The middle 50% of the distribution of responses ranged from 1 basis point to 10 basis points, again likely reflecting some uncertainty over pricing, as well as diversity in investment strategies among FICC. For example, high yield or emerging markets credit research would likely price higher than coverage on domestic government bonds or investment-grade credit from large issuers.

Based on the respective interquartile ranges for equity and FICC, respondents expect FICC research to cost roughly half as much as equity research. One possible interpretation of this finding is that research may be a more significant component of alpha generation for active equity strategies than for FICC strategies. If that were the case, managers would be willing to pay more for equity research. Another interpretation is that FICC markets, by nature, are more heavily influenced by macroeconomic factors, suggesting that FICC-specific research may be of lower value in and of itself.

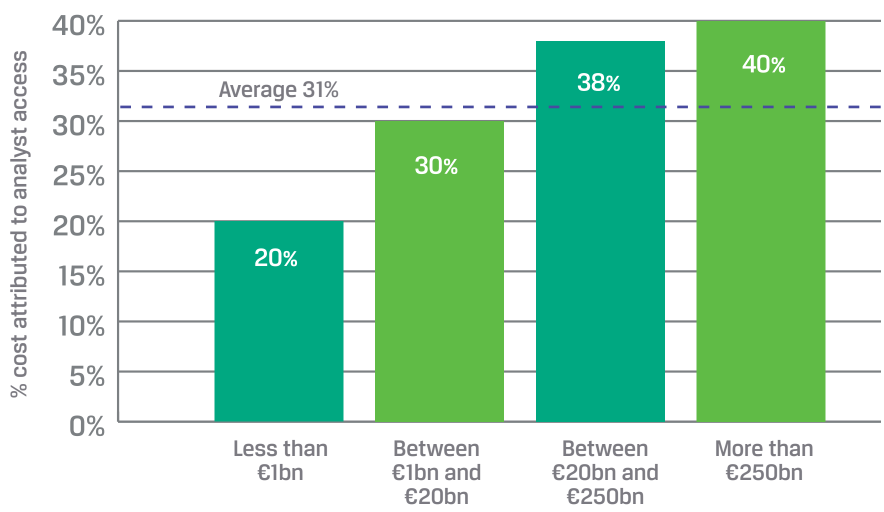
Another (practical) consideration is that establishing a cost for fixed-income research is more difficult than for equity research, because unlike equities, no commission is charged by dealers for executing fixed-income trades; dealers are instead compensated by the bid-offer spread. Consequently, it may be harder to back out an expected price for fixed-income research from existing execution costs than it is for equities.

On average, survey respondents attributed 31% of aggregate research costs to analyst access (versus written research reports), as illustrated in **Figure 9**. There is a statistically significant difference between the attribution of costs to analyst access between large and small firms: respondents from firms with AUM greater than €250 billion attributed 40% of research costs to analyst access, double the proportion from respondents from firms managing less than €1 billion.

RESPONDENTS EXPECT FICC RESEARCH TO COST ROUGHLY HALF AS MUCH AS EQUITY RESEARCH

FIGURE 9: **ATTRIBUTION OF TOTAL RESEARCH COSTS TO ANALYST ACCESS, BY FIRM SIZE (AUM)**

Please estimate how much of the cost you expect to attribute to analyst access versus read-only access?

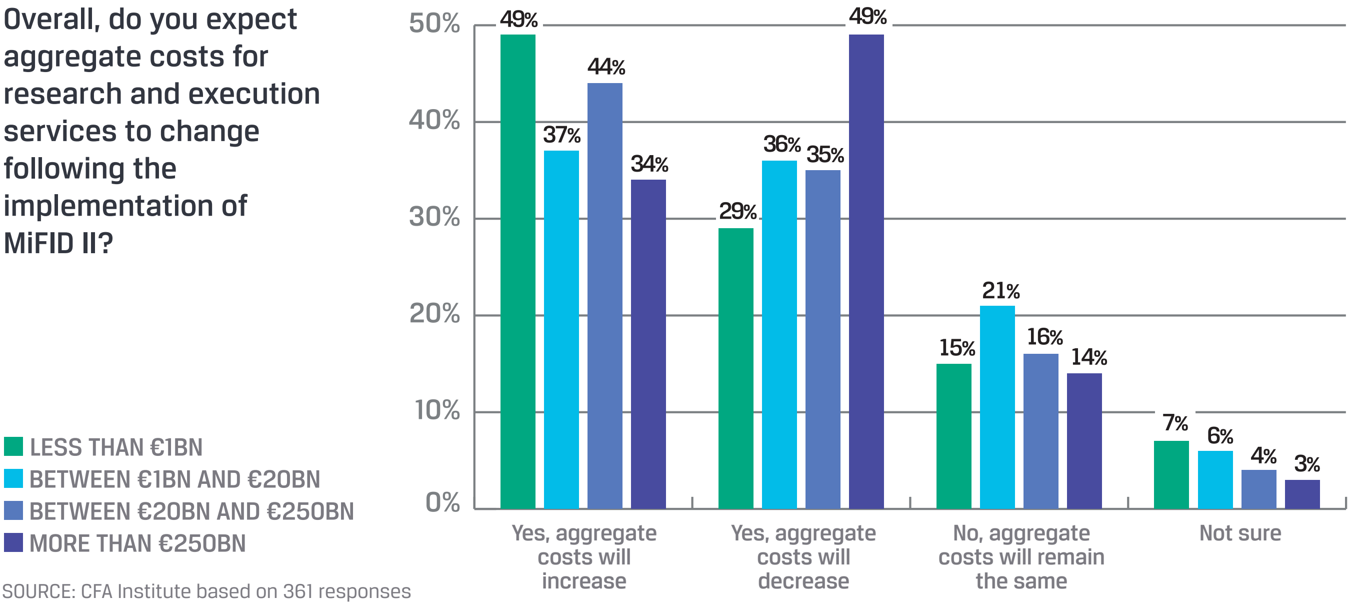


SOURCE: CFA Institute based on 361 responses

Since the survey was conducted in September, anecdotal evidence suggests that research providers are continuing to reduce prices for written research reports and charge more for individual access to analysts (e.g., calls and meetings). Tiered pricing structures are emerging, with several investment banks significantly reducing prices for written research, whilst offering premium prices for analyst access. Competition and the desire to retain clients are also factors driving down quoted prices. If these trends continue, it is likely that the proportion of firms' research budgets allocated to analyst access will increase.

Survey respondents were next asked whether they expected aggregate costs for research and execution services to change following the implementation of MiFID II. Responses were mixed, with no clear consensus as to whether aggregate costs would increase or decrease overall. However, there is significant variation in responses by firm size and by asset class.

FIGURE 10: **IMPACT ON AGGREGATE COSTS, BY FIRM SIZE (AUM)**

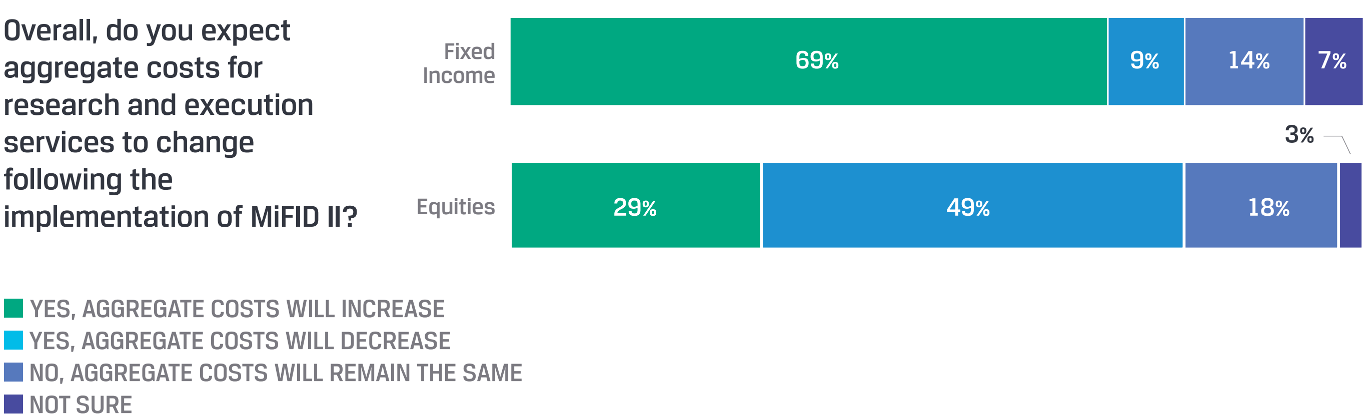


SOURCE: CFA Institute based on 361 responses

As **Figure 10** illustrates, respondents from large firms are more likely to agree that aggregate costs will decrease than respondents from small firms. Specifically, 49% of respondents from firms with AUM greater than €250 billion thought aggregate costs would decrease, whilst 49% of respondents from firms with AUM less than €1 billion thought aggregate costs would increase.

Responses are also polarised according to asset class, as shown in **Figure 11.** Respondents with fixed income as their primary investment practice are far more likely to agree that aggregate costs will increase than respondents with equities as their primary investment practice. This implies that investment professionals do not believe fixed-income spreads (execution costs) will go down as a result of broker-dealers charging separately for fixed-income research.

FIGURE 11: **IMPACT ON AGGREGATE COSTS, BY PRIMARY INVESTMENT PRACTICE**

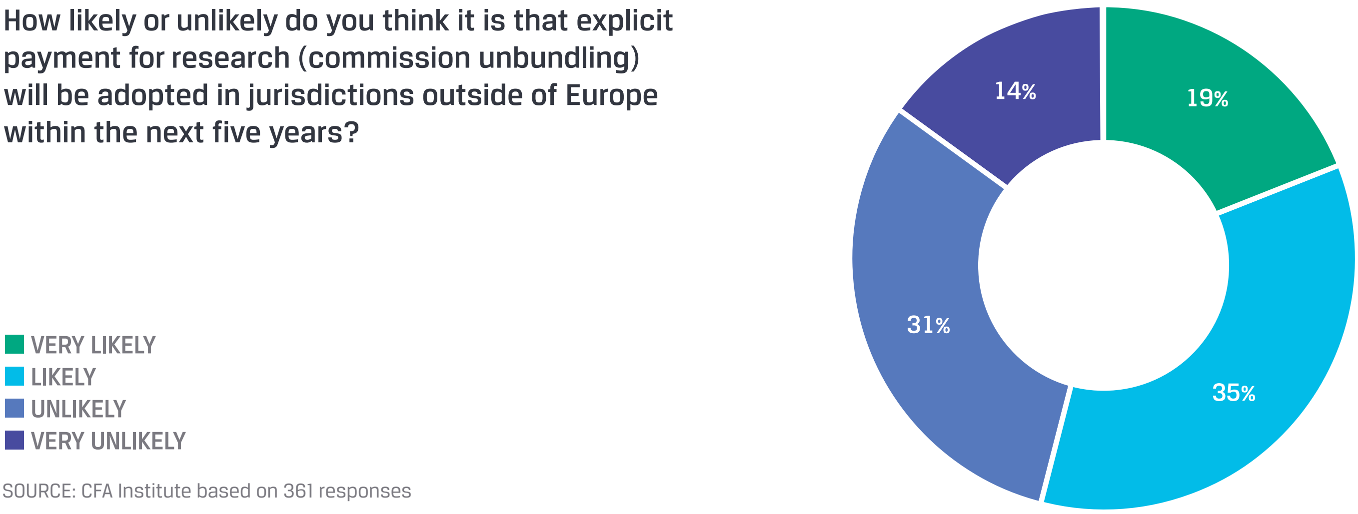


SOURCE: CFA Institute based on 361 responses

The survey next asked respondents about their views on the likelihood of explicit payment for research being adopted in other regions over the next five years. As shown in **Figure 12**, responses were reasonably split. Excluding respondents who were unsure, 54% agreed that it is likely or very likely, whilst 45% thought it is unlikely or very unlikely.

FIGURE 12: **EXPECTATIONS OF EXPLICIT PAYMENT FOR RESEARCH BEING ADOPTED OUTSIDE EUROPE**

How likely or unlikely do you think it is that explicit payment for research (commission unbundling) will be adopted in jurisdictions outside of Europe within the next five years?



SOURCE: CFA Institute based on 361 responses

Finally, survey respondents were asked to provide any other comments on MiFID II. The views expressed were generally negative, indicating a high degree of scepticism amongst investment professionals that the reforms will deliver good outcomes for investors, firms, and markets. These views are captured in a word cloud (prominence equates to the weight of responses).

SOURCE: CFA Institute

5. CONCLUSION

MiFID II heralds a sweeping reform of financial markets and business practices. Amongst many other changes, it is set to disrupt the production and distribution of investment research, impacting on execution services as well as the costs borne by investment management firms and investors.

CFA Institute supports the objectives of these reforms, which are to remove potential conflicts of interest between asset managers and their clients when transacting with brokers, and to deliver a more transparent, competitive, and efficient market for research.

But the rules are not a panacea. Investment professionals responding to our survey expressed concerns over unintended consequences, such as a decrease in the availability of research, including of smaller companies.

Responses to the survey confirm the trend towards asset management firms absorbing research costs rather than charging clients. Yet they also highlight a disparity between large and small firms, with large asset managers more likely (and more able) to absorb research costs than small asset managers, suggesting a competitive advantage for larger firms.

Perceptions of the cost of research varied both within and across asset classes, which serves to illustrate the complexity of ascribing a value to research. Pricing negotiations between asset management firms and research providers are ongoing, and it may be only after the implementation of MiFID II that industry convergence emerges.

Views were also mixed as to whether aggregate research and execution costs would rise or fall, with equity investors mostly optimistic that costs will decrease, whilst fixed-income investors are pessimistic.

It may be several months or years before the full effects of MiFID II crystallise. In the short term, asset management firms must focus on operational issues including the method of allocating research budgets across different strategies or clients, and how to deliver process efficiencies whilst ensuring that research procurement across different regions remains compliant with local securities laws, which may conflict with MiFID II.

Successfully adapting research business models will determine the competitiveness and value proposition of firms.

With reduced expected consumption of sell-side research, it is likely that investment banks will seek to remodel their service offerings, such as by scaling back analyst coverage of the most heavily traded securities or reducing ‘waterfront’ coverage. Overcapacity must be eliminated. Independent research providers may find themselves competing with investment banks on a more level playing field in which research consumers can compare price and quality across products and service levels. Opportunities to grow market share will arise for firms that can differentiate their offerings and deliver value-adding insights.

If these changes materialise, investors stand to benefit from an increase in research quality and thus more informed investment decision-making. The transition to the new paradigm may be disruptive, but it promises to deliver a more efficient market in the long run.

THE TRANSITION MAY BE DISRUPTIVE, BUT IT PROMISES TO DELIVER A MORE EFFICIENT MARKET IN THE LONG RUN

AUTHOR

Rhodri Preece, CFA
Head, Capital Markets Policy
Europe, Middle East and Africa

CONTRIBUTORS

Kurt Schacht, JD, CFA
Managing Director, Advocacy

Gary Baker, CFA
Managing Director, Europe, Middle East and Africa,
and Managing Director, Research

David Zhang
Customer Insight and Market Intelligence Analyst

EUROPE, MIDDLE EAST AND AFRICA
Telephone +44 (0)20 7330 9500

67 Lombard Street
7th Floor
London EC3V 9LJ
United Kingdom

Rue de Champ de Mars, 23
1050 Brussels
Belgium

THE AMERICAS
Telephone (800) 247 8132 (US and Canada)

915 East High Street
Charlottesville, VA 22902
USA

477 Madison Avenue
21st Floor
New York, NY 10022
USA

ASIA PACIFIC
Telephone +852 2868 2700

23/F, Man Yee Building
68 Des Voeux Road
Central, Hong Kong SAR

Si Wei Beijing Enterprise Management Consulting Company Limited
Unit 5501, 55/F China World Tower B
No. 1 Jianguomenwai Avenue, Chaoyang District
Beijing, 100004, China

CFA Institute India Private Limited
Naman Centre, Unit No. 103
1st Floor, Bandra-Kurla Complex, G Block, Bandra (East)
Mumbai 400 051, India

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