MiFID II at a Glance

BRUNSWICK

- **MiFID II comes into effect on 3rd January 2018.** For corporates, this will have important implications for which they need to start planning now.

- **MiFID II is designed to offer greater protection for investors** and inject more transparency into investment managers' relationship with brokers. As a directive, it is up to individual Member States to implement MiFID II. Currently, only half of the 28 EU countries have adopted MiFID II into law.

- **One of the key impact of MiFID II for corporates** is the requirement for banks to charge fund managers for their research separately, rather than it being bundled as part of a wider service. Spending on research will fall as fund managers absorb the costs into their own P&L. This will likely have an impact on how much research is produced, and which companies are covered.

- **The number of analysts covering companies will likely decline** as the spotlight shines on the high costs of research for banks, the likely difficulty of recovering these costs in fees, and which research really adds value. As a result, some smaller companies now used to regular dialogue with analysts, and those in out-of-favour sectors, might find themselves dropped from analyst coverage, or covered only sporadically as the commercial focus shifts to larger or more liquid companies.

- **Fund managers are doing more of their own research** and have a greater appetite to engage directly with companies. Similarly, boutique research houses and those producing paid-for research are likely to expand.

- **There could be unintended consequences.** For example, if fewer analysts cover a stock, how will the market reach consensus earnings? How will investors research companies that are not covered? Will other forms of research, either written or technology-driven, come to the fore? How will journalists and other market observers access research?

- **Companies will need to ensure they have a clear story** and that it reaches the right audiences. IR teams may also need an increase in skills and size, and indeed we are already seeing this at some companies. As a starting point, companies should ensure they understand what investors think, what they will require, and what best practice looks like.

- **MiFID II does not alter the distribution of research to journalists** by companies, although later iterations of the directive could contain language to address this subject.

How Brunswick Can Help

We have highlighted several immediate, concrete actions for companies and discuss how Brunswick and our Investment Engagement team can help.

IR Priorities	Why does this matter?	How Brunswick can help
Ensure that your IR team is fit for purpose	• With potentially less research coverage, IR teams will play a critical role in communicating the company's narrative to the investor community • Current IR teams will come under increasing pressure as responsibilities expand to handle increased requests for information, direct contact with investors, and guidance queries • IR budgets might need to increase	• End-to-end communications support to IR teams • Advice and practical implementation of investor narrative, intelligence on investor landscape, and better distribution of equity narrative through non-traditional channels
Understand the investor landscape	• Investors will have to pay for corporate access under MiFID II, limiting range of interest • IRs need to become more familiar with a wider range of non-holders and smaller investors • With the increase in passive investments, it will be important for corporates to understand how investors will vote on the issues that matter (e.g. transparency, remuneration, ESG)	• Provide unconflicted investor intelligence on: non-holder target list, key jurisdictions, passive funds • Evaluate and support governance and sustainability communications • Benchmark against peers on governance issues
Sharpen the investor narrative	• With fewer analysts covering a stock, ensure that the message is clear, effective, and reaches the right audiences • Particularly important for small and mid-cap stocks to be proactive in selling their own story	• Help to develop, market test and refine investor narrative • Conduct investor perception studies to align investment case with business case • Train management and support at investor events including Capital Markets Days and AGMs
Expand monitoring of sector trends	• With expected contraction in overall research coverage, look to other resources for information on macro and industry trends	• Knowledgeable, objective discussion of investment landscape and trends • Brunswick Insight conducts specialised surveys and focus groups
Use non-traditional platforms	• With less research available, consider digital marketing channels that target investors directly	• Brunswick digital team support includes: LinkedIn, Twitter and Facebook targeting, digital marketing campaigns, digital-only financial media, social media listening • Video and infographics communicate an investment case concisely and effectively
Consider additional coverage options	• Asset managers likely to be more selective in the research that they buy • Small and mid-cap stocks likely to be overlooked • Boutique investment firms and paid-for research might be a solution	• Communicate on behalf of the company • Engage with analysts to manage understanding of the business and investment case

If You Want to Know More

Context and objectives

MiFID is a piece of EU legislation that provides a framework for the provision of investment services and the operation of markets. It was applied in the UK from November 2007, and after the 2008 financial crisis highlighted a number of shortcomings in the legislation, a comprehensive review took place to improve the functioning of financial markets and strengthen investor protection. The new legislation includes a revised MiFID and a new Markets in Financial Instruments Regulation (MiFIR).

Impact on the buy and sell side

The key change for corporates will be the requirement for fund managers to pay banks and brokers directly for analyst research, instead of the current practice where research is received for free with the cost paid for from investment management client trading commission. The purpose of this condition is to demonstrate that the fund managers are not being induced to trade and it will require them to budget separately for research and trading costs. While there is still uncertainty for asset managers around how and how much they will pay for research, most asset managers are choosing to absorb the cost of external research, with only a few considering passing the cost on to their clients through higher fees.

Differences in approach

As MiFID II is a Directive, it is up to each of the Member States of the EU to implement it individually, which could potentially lead to slight differences in approach across different jurisdictions. There is the possibility that national regulators could add further provisions on top of the minimum requirements prescribed by the Directive, or have a different interpretation of the common law. The question around what constitutes corporate access is an example of this. The AMF in France has adopted a flexible approach, differentiating between a simple corporate access service versus more value-added services, while the FCA in the UK is more rigid in its definition.

Communities affected

MiFID II will have a profound effect on the entire financial industry. The new rules will affect all trading within the EU and will therefore affect all market participants, including institutional investors, retail investors, hedge funds, exchanges, brokers, and high frequency traders. It also applies to all asset classes, from equities to fixed income, forex and exchange traded funds.

The new regulation will also have cross-border consequences. The EU does not have a direct influence over non-EU domiciled firms, but the new rules will have an indirect impact on these firms. To comply with MiFID II, European firms may be required to demand additional disclosures and reports from non-EU counterparts. One of the biggest issues for the US will be the new rule that requires fund managers to pay separately for research. Under US legislation, brokers cannot receive direct payment for research unless they are registered as investment advisers, which means that they will not be able to provide research to European clients once MiFID II has been implemented. The SEC has recently announced an exemption to allow brokers to continue to provide research to EU investment firms once MiFID II comes into force.

Implications for corporate coverage

As more asset managers move to paying directly for research, they are also expected to become more particular about the research they receive and who they receive it from. This will lead to a fall in demand for research from sell-side firms as buy-side firms are expected to bring more research inhouse, or potentially make more targeted use of independent research firms as a result of the changes.

With this fall in demand, sell-side firms will start reducing the number of companies that they cover, with perhaps only the top five investment banks retaining waterfront coverage. This, in turn, could lead to a reduction in good quality research, particularly for small- and mid-cap stocks. Although the aim of MiFID II is to provide better value to investors, the decrease in information could have the unintended effect of reducing liquidity in certain stocks, creating more volatility.

What this means for communications and Investor Relations

In anticipation of decreased sell-side support, companies will need to ensure they have a clearly articulated investment case and that they communicate it to the right audiences via a rich suite of materials that tell this story in an engaging way. Financial communications should therefore incorporate materials such as leadership videos where the strategy and outlook for the company are explained, along with infographics that provide a visual snapshot of the corporate narrative. A good digital strategy, supporting these communications, will also be critical. With companies unable to rely on the sell side to communicate with investors, consideration should also be given to investing in IR budgets and/or increasing the size of IR teams.

More information

Brunswick would be delighted to talk to you further about the impact of MiFID II and how we can help.

For discussions at a senior management level, Sir Jonathan Faull has recently joined Brunswick as Chair of our European Public Affairs team.

Please speak with your Brunswick contact or email: MIFIDII@brunswickgroup.com

Who We Are

Brunswick is an advisory firm specializing in business critical issues. We help companies build trusted relationships with all their stakeholders.

For more information, please visit: www.brunswickgroup.com