European Forum of Securities Associations (EFSA)

24 March 2023

**EFSA response to the EC consultation on financial research**

## GENERAL COMMENTS

1. We agree with the EC that the success of MiFID2 unbundling is contestable. Not only has it not resulted in the growth of independent investment research providers (which should not be a regulatory purpose per se[1]), but more importantly it has impaired availability of research on SMEs in most countries. It has also led to a decline in the research on the most liquid shares, which in our opinion was not an objective to be pursued to the extent that, as rightly pointed out by the EC, payments for research on large companies provide funding for research on small and mid-caps, the production of which is not economically sustainable per se[2].

2. We also agree with the EC that the unbundling exemption provided for by the Capital Market Recovery Plan (CMRP) for research on issuer capitalizing up to 1 billion proved unable to reverse the above negative trend in the production of research on small caps, due to the investment firms' reluctance in introducing a double invoicing system. We doubt, however, that the current EC proposal to raise the relevant threshold from 1 to 10 billion would by itself reduce such reluctance from the investment firms and, more importantly, from asset managers.

[1] In fact, we disagree with the concept of independence adopted by the EC, which considers research to be independent if it is not produced by a broker. From our perspective, firstly, we would consider all non-sponsored research to be independent, regardless of whether it is produced by a broker or not. In addition, we would also consider sponsored research to be independent to the extent that it is commissioned from a supervised intermediary that has to comply with the strict conflict of interest rules in the MiFID and MAR.

[2] Global brokers, who dominate the market for research on highly liquid shares and which could indeed use the relevant revenues to fund the cost of research on less liquid share, are not interested in this sector of the market. In fact, they are actively involved in the production of research on small and mid-cap (which can only be marketed locally) only when they participate in the lucrative IPO process but neglect them in their subsequent life cycle. Conversely, local brokers - who have a vital interest in the development and consolidation of their domestic markets and, therefore, in financial research on local SMEs – are currently experiencing a reduction in the revenues on research in large companies and are therefore no longer able to use such payments to fund research on small and mid-caps.

**European Forum of Securities Associations**

EFSA members:

Asociación de Mercados Financieros (AMF)

Association française des marchés financiers (AMAFI)

Associazione Italiana degli Intermediari dei Mercati Finanziari (ASSOSIM)

Belgian Association of Stock Exchange Members (ABMB-BVBL)

Bundesverband der Wertpapierfirmen (bwf)

Capital Market Denmark (CMD)

Polish Chamber of Securities Brokers (IDM)

Swedish Securities Markets Association (SSMA)

*Internet: www.efsa-securities.eu*
*Mail: contact@efsa-securities.eu*

*EU Transparency Register: 038014348035-13*

3. Assuming that the newly proposed higher threshold would trigger the willingness of investment firms (and asset managers) to adopt a dual invoicing-system, still the revenues generated by the research and trading on mid-caps[3] would never be sufficient to fund the cost of research on small-caps[4] (which seems to be the final objective of the proposal). In fact, in most countries the number of issuers capitalizing less than 1 billion exceed by far the number of issuers capitalizing between 1 to 10 billion[5]. On the other hand, the very few issuers which capitalize more than 10 billion and that, as such, are excluded from the scope of the new bundling regime proposed by the EC, attract the vast majority of the trading fees[6] as well as of the research coverage. For the above reasons the concept of an exemption threshold as such does not seem convincing.

**SPECIFIC COMMENTS ON THE EC PROPOSALS:**

4. In the light of the above, we doubt that increasing the exemption from the ban on incentives from 1 billion to 10 billion would in itself be sufficient to remove the barriers that currently prevent the production of an adequate level of financial research on SMEs. In fact, if it is true (as we believe it is) that (i) raising the relevant threshold to 10 billion would not lead investment firms to "bundle-back" trading and research costs (and thereby introduce the double invoicing system that has discouraged investment firms from seizing the opportunity introduced by the CMRP) and that (ii) payments for research on larger companies could be one way to fund research on smaller companies, in order for the current EC proposal to have the desired effect it is in our opinion necessary to supplement it with some further actions:

    i. A necessary but not sufficient precondition would be to exclude financial research from the scope of the inducement regime all together[7]. To the extent that the vast majority of trading volumes and research coverage is concentrated on the most liquid shares (those issued by companies with a market capitalization of more than 10 billion) it would be quite difficult, as envisaged by the EC, to fund the costs of the research on small-caps with the revenues arising from research and trading fees generated by the very few larger companies which will be captured by the higher threshold provided for in the current EC proposal;

    ii. On top of that, it is absolutely necessary to remove current requirements which prevent research producers from marketing their research to potential clients (free trial). To trigger better quality research, promoting competition in the relevant market is of the outmost importance; to this end, the EC should exclude research on issuers with a market capitalization below 10 billion (or, as stated above, all financial research) from the scope of Article 24, paragraph 9a, letters a) and b), of MiFID2 (as amended by the Quick Fix) and thereby remove (i) the need for the relevant parties to enter into a specific contract prior to the start of the trial period and (ii) the need for the research recipient to make and keep records of how it complies with the relevant requirements.

[3] Research on issuers capitalising up to 1 billion.
[4] Research on issuers capitalising up to 1 billion.
[5] In Italy, for example, for every company with a capitalization of between 1 and 10 billion, there are more than 5 with a capitalization of less than one billion (338 out of 400).
[6] In Italy, the trading volumes on the 15 issuers with a market capitalization of more than 10 billion account for 70% of the total. Moreover the 40 issuers included in the main market index (FTSE-MIB) generate more than 90% of the trading volume and the vast majority of research coverage by both foreign and domestic analysts.
[7] We are actually firmly convinced that financial research should even be excluded from the scope of the definition of inducement.

5. We welcome the EC proposal on sponsored research and consider that it would be a suitable and feasible solution to promote research on small and mid-caps. To this end, we would support a safe-harbour scheme whereby sponsored research is recognized as investment research where it complies with a code of conduct endorsed by a competent authority or a market operator[8]. Indeed, these codes of conduct can contribute to the setting of a clear legal framework, provide safeguards against conflict of interests and promote independence and transparency as well as strict conditions for the payment and dissemination of research, so as to make sponsored research equivalent to non-sponsored investment research in terms of their content and quality.

6. As to the EC proposal to collect and disseminate sponsored research thorough the European Single Access Point, we believe that any such requirement should take into account the need for the research producer to be aware of the identity of any third party having access to its research and thereby be provided with such information.

7. Finally, we would like to provide our arguments as to the reason why in our opinion financial research should not be considered as an inducement:
   i. It does not improperly influence the conduct of portfolio managers, but rather supports them in acting in the best interest of their clients;
   ii. It is acquired by portfolio managers in the name and on behalf of their clients under the management mandates. Accordingly, even if it were to be considered an inducement, it would nonetheless be a legitimate inducement, in that its economic functionality is transferred from the asset managers to their clients; and
   iii. Finally, it might be worth mentioning that by including financial research within the scope of the provisions on inducement in Article 13 of the Delegated Directive (EU) 2017/593, the EC exceeded the mandate received from the co-legislators under Article 24, paragraph 13, lett. d). In fact, the EC mandate was not to establish which non-monetary benefits fall within the concept of inducement, but rather to set out the "*criteria to assess compliance of firms receiving inducements with the obligation to act honestly, fairly and professionally in accordance with the best interest of the client*".

[8] In France, a Code of conduct for sponsored research (see *AMAFI / 22-74*) was established in May 2022, with at present 210 companies covered though this type of research.