RESEARCH SERVICES AND THE CHANGING BEHAVIOURAL PATTERNS OF ASSET MANAGERS IN THE POST MIFID 2 WORLD

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Impact on market participants

The breadth of the regulation captures, directly and indirectly, a wide range of buy-side firms, varying in size and strategies, as well as their sell-side research services providers (both traditional and independent). Whatever the actual level of preparedness of asset managers and hedge funds some clear trends have emerged in the first eight months of MiFID 2 including:

- Many firms (including the larger global firms) have decided to absorb the cost directly rather than pass this through to the funds
- Smaller firms, themselves not heavy users of research services and rely mostly on access to written content, have also opted to absorb the costs where there is an agreed (or perceived) fixed cost.

In terms of readiness, the decisions around process, technology and overall approach have been impacted by:

- The time it has taken to negotiate the price for research which has been longer than many expected, with some firms spending the best part of 2017 either in discussion or waiting for industry consensus. In many cases the negotiation of legal agreements has also taken significant additional time with content and construct varying between participants
- Mis-matches between perceived value and volume because of commercial terms and consumption models based on previous usage data
- Some buy-side firms using historical consumption data (sourced directly from buy-side or via various technology vendors) as the method to determine research payments (via agreements) and/or ongoing re-negotiation have identified erroneous data entries affecting the quality of the data sets leading buy-side firms to re-think their original approach.
- A decrease in use of sell-side analysts and associated interactions by the buy-side due to;
  - Reductions in overall research budgets
  - A focus on “known” value add research providers at the expense of others who may have added some fringe value in the past but not necessarily enough to justify meaningful spend
  - Lack of knowledge or transparency of buy-side professional budgets; these are in place at some institutions but often cannot be shown dynamically to give a point in time usage and spend level versus any defined individual or team budget

Changing behaviours

Looking past the noise around the regulation that hit a crescendo in December 2017, and the oversimplification of categorising managers as either absorbing the cost of research services or not, several consequences are emerging:

- Buy-side firms absorbing research services costs directly struggle in how to manage it dynamically. In particular regarding;
  - How to allocate costs at the fund or team level and at the granular level of the investment professional that reflects an accurate cost based on usage (is an ‘internal rate card’ method preferred over an implied value of research services based on consumption)
  - Finding a method, with little or no internal data points, to track and evaluate the value of services received rather than relying on consumption-based metrics alone. Time spent by investment professionals to evaluate research services is a major consideration and often leads to a ‘path of least resistance’ but reliance on consumption data paints a one-sided picture

- Where firms continue to pass on research costs to clients, they struggle to find solutions to help comply with regulations; technology providers may offer function rich but often expensive, off-the-shelf turn-key platforms, which have little or no propensity for customisation to an industry that has many unique features, and which does not suit a "one size fits all" approach
- The introduction of research agreements (between sell-side firms and their buy-side clients) and the spread between research cost vs value received which introduces;
  - Complexity for the buy-side as pricing can be divergent for similar types of services
  - Smaller firms who struggle to accept the new pricing policies may be cut-off or limited to accessing content only
  - Independent research providers (IRPs) have not been unaffected by these new agreement methodologies, creating pressures on their margins as the cost of research content overall has been driven to low levels
- Investor expectations need managing regardless of whether absorbing the costs or passing them through. This is not limited to funds directly within scope of MiFID 2 but also indirectly impacts those in the US and in Asia. Investors are increasingly questioning how funds are managing research service costs.

Certainty in the unknown or known uncertainty?

As the post-MiFID 2 world starts to take shape, many questions still remain open;

- The pricing negotiation period has been prolonged with the topic of valuation of research services still very much at the forefront. How certain are these prices and how will this change negotiations beyond 2018:
  - Do prices remain the same?
  - Will the buy-side drive pricing down further?
  - Will the sell-side seek to raise prices from a base level based on consumption for certain services?
- The provision of a-la-carte pricing agreements is low currently but might the buy-side drive this behaviour going forward (consumption-based demand with a more formal data value approach)?
- Continuing without an accurate and meaningful dataset and an understanding of what and how research interactions are valued, invites increased uncertainty to informed pricing discussions with the sell-side and internal pressure to justify budgets but will buy-side firms simply adopt old subjective voting practices with an overlay of consumption to relieve the time pressure on investment professionals vs. taking responsibility for their actual research spend?
- Regardless of jurisdiction, will investors and allocators deem MiFID 2 as a gold standard when it comes to justification of research services and prompt funds in the US and Asia to adopt approaches and technology to ensure payment for these services are accurately accounted for?

One thing remains clear, it is still early in the evolution of the MiFID 2 genesis with lots still to do on this journey until an industry equilibrium is reached. This is of course based on what is currently known and assumes the certainty that there are no further regulatory changes. But, as we note at the outset, investment management is a dynamic global industry and we should not expect the international regulatory framework to remain static. Indeed if the response from the FCA in the middle of the year is anything to go by, there is still some way to go.

Quintain Analytics *(www.quintainanalytics.com)*

Quintain Analytics is a data technology company creating products and solutions for the buy-side investment community around attribution and cost allocation of research services. With clients across UK, Europe and Asia, Quintain Analytics is helping firms accurately account for valued interactions and the impact on research budgets (or vote process) along with benchmarking tools to assist in the ongoing or future renegotiation of research agreements.