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WHITE PAPER

# ARE YOU SURE YOU'RE PREPARED FOR MiFID II?

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Residents of the east coast of Florida are used to warnings by local authorities about approaching hurricanes. The warnings always come with instructions to prepare well in advance but invariably, large numbers of people leave their storm preparations to the last minute. Perhaps they don't take the risk seriously, or they are too busy with work, but when it becomes painfully obvious the storm is about to hit, these are the people shown on the news trying to put up storm shutters as the gale-force winds swirl around them.

Although the context is vastly different there are some parallels between the scenario above and the looming January 2018 implementation of MiFID II. With only six months until the regulations come into effect even the procrastinators have realized that they need to put in place a system to comply. Just like the guy on the stepladder twelve hours before the Category 5 hurricane comes roaring ashore, they are now frantically trying to prepare for it. For many firms, this is leading to desperation based decision making.

In our previous reports on MiFID II, we've explored the regulation's impact on both Corporate Access and Investor Relations teams, focusing on how the regulations will impact the day to day work life of the main stakeholders in the Corporate Access process. In this paper we are taking a slightly different approach and examining whether the tracking and reporting solutions that are being proactively implemented by a number of sell side firms as a measure to comply with MiFID II are the best long-term solution for the buy side and if not, what an alternative might look like.

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To read our previous white papers on MiFID II, follow these links:

**How technology can help firms tackle the MiFID II regulations for Corporate Access**
scan QR code or visit: http://alturl.com/fxykd

**Looking to the future: MiFID II and the impact on Investor Relations**
scan QR code or visit: http://alturl.com/fo6np

## READY-FIRE-AIM

In a March 2017 poll by ITG, 60% of asset management companies said they were waiting until MiFID II launches to implement unbundling, while 31% did not yet know how they would pay for research after that point. Many firms are now rapidly escalating their response to MiFID II and the recently released European Securities and Markets Authority (ESMA) Q&A paper on MiFID II has helped these efforts by adding further clarity to the level of compliance required when the regulations come into effect on the 3rd January 2018. Despite this increased clarity though, many of the processes and systems that are being put in place appear to us to be simply layering extra administration on top of existing workflows without addressing the underlying issues with the way research and corporate access are priced and delivered.

MiFID II is driving a degree of "implementation panic" that is bringing a ready-fire-aim mentality to the sell side's preparations, and in turn potentially creating another set of longer-term inefficiencies. As is well documented, a core requirement of MiFID II's research provisions involves unbundling research and corporate access services from trading commissions, and essentially tracking and paying for them separately. In response to this (and in the spirit of MiFID II compliance), sell side firms are opting to break out every single minute element of research and corporate access delivered to clients, put it all into a huge data file, and leave the job of deciphering what is valuable and what is not to the client, something akin to drinking from a fire hose. This goes beyond simply itemizing research reports and company meetings provided, it also includes emails, instant messages, sales calls and even voicemails - irrespective of whether the buy side client welcomes the provision of these services. In trying to accommodate MiFID II's requirements, the sell side is generating enormous volumes of data and delivering to clients a list of mostly unwanted information in the hope that they will agree to ultimately pay for at least some of it. Moreover, the buy side client has to take this wall of information, distill it and reconcile what it wants versus what it gets.

As the data from the ITG poll listed above highlights, a large part of the industry is unprepared for MiFID II and given the increasing realization by many firms that they simply must have a solution in place by January 2018 it is understandable that many are in the mindset of short-term risk management rather than focusing on a long-term solution that brings efficiencies to the whole industry. Our belief is that in an effort to be compliant, firms are sleepwalking into simply maintaining the same outdated workflows with an extra layer of administration placed on top and that the work involved in this will prove to be a costly distraction for Portfolio Managers by taking them away from what they should be doing - investing.

Financial institutions are at an important crossroads and the danger is, that at a time when there is a real opportunity to make meaningful, positive change to the way the industry operates, poor workflows will be embedded rather than taking the opportunity to recalibrate and vastly improve the way research and corporate access is produced, consumed and utilized. Our hope is that the focus will start to shift onto building an efficient, transparent marketplace for the services that the buy-side truly cares about - ultimately the evaluation of services and payment should be based on user generated data and value assessments based on what Portfolio Managers are actually reading and attending.

## HOW DID WE GET TO THIS POINT?

It is worth taking a quick look at how we arrived at this point. The MiFID II regulations and the proposals by the UK FCA that preceded them were in many ways a response to the way pricing around research and corporate access was managed. When looking historically at how these services have been provided and consumed, there was not only a complete lack of transparency on the cost of the specific services but also no comprehensive record of the services provided and in the majority of cases not even an evaluation by the consumer of the service as to whether they received any value. This system would be completely unfathomable to anyone outside of a financial institution and it is difficult to think of an industry that operates in a comparable way.

Our view is that MiFID II actually offers an exciting opportunity to shift the entire process of provisioning and consuming research and corporate access services to a transaction-based pricing approach where the buy side could see a clear price on each service provided, down to the individual research report, meeting or hour of time spent with an analyst and/or corporate management. A fully transaction based pricing model would ensure the industry operates in a far more efficient way and importantly provides value to the most important stakeholder in the whole process - the clients who invest their money into funds and pensions.

Although a significant departure from how research and corporate access has historically been paid for, there are a number of advantages to truly monetizing along these lines:

1. The buy side would enjoy transparent pricing, aligned with the service being provided, potentially right down to the specific time period spent on the phone with an individual analyst or management meeting – making it far simpler to account for the cost and value of each.

2. The buy side would accordingly only purchase those services that provided value, introducing market forces into the process and ensuring that providers of the best quality products are also the most successful.

3. Low quality providers would be incentivized to improve or exit the business.

In comparison to the kind of transaction-based pricing approach that buy side firms employ for virtually every other service they consume, the above is not a revolutionary concept and the transformation of research and corporate access services to a transaction-based model has to a certain extent already started at a number of firms. As of yet though, there is no concerted, collaborative effort within the industry to fully implement such a system. Instead, the primary focus is on anchoring compliance with MiFID II's research regulations on itemizing every single service provided, right down to the voicemail left by a salesperson, rather than focusing on building an efficient marketplace for the activity that is most highly valued i.e. access to corporate management and analysts.

**HOW TO MOVE FORWARD?**

It is important to pause for thought, and envisage what the situation will look like 18 months from now. Do asset managers really want to be in the position where they have to download a spreadsheet from their service providers that contains a list of everything that has been provided, upload that to their own system and then reconcile the data? This is exactly the type of manual process that has been made obsolete in other operational areas such as trading.

Instead, buy side firms should be asking themselves some key questions:

1. How can technology be leveraged to manage data and ultimately help firms assess which services are valuable and which are not?

2. Should buy side firms themselves be responsible for producing their own consumption reports rather than passively relying on the sell side to provide them lists of data on services they do not value?

3 Are there platforms that automate the tracking of consumption and interest levels so that both the sell and buy side can genuinely determine what is important and what is noise?

Most importantly is the need for some analysis on what steps need to be taken for the industry to move towards a truly market based pricing model for these services. There are a number of specific challenges that need to be overcome before we can progress in this area:

1. The confusion around what exactly will qualify as research and corporate access under MiFID II needs to coalesce around standardized definitions for each service. Such an accepted framework is necessary for the playing field to be level and for both the buy side and their service providers to be speaking the same language.

2. Service providers need to go through the painful process of getting a better understanding of the true cost of the services they are providing.

3. Each service provider needs to determine their "rate card" for the individual services they provide. Over time the market will ultimately determine the industry's collective "rate card" – the ranges companies will be willing to pay for certain services, bounded by the respective high and low-cost providers. Those who overprice or under-deliver will be forced to adjust accordingly, providing true price discovery.

Both sides developing a joint understanding in these areas will be key to moving forward. The legacy approach to research and corporate access has meant there has never been an open and honest conversation around not only the value of the service being provided but most importantly it's true cost. In our conversations with both the Sell Side and the Buy Side it is very clear that there is a large gap in what the service provider believes is a correct price and what the buy side is willing to pay. Taking just one example, it will not be sustainable in the longer-term for the sell side to run multi-city roadshows with corporate management based on the prices that a number of large asset management firms are currently proposing to pay for meetings. Until these differences are confronted, we are unlikely to make significant progress.

**TAKING A STEP BACK**

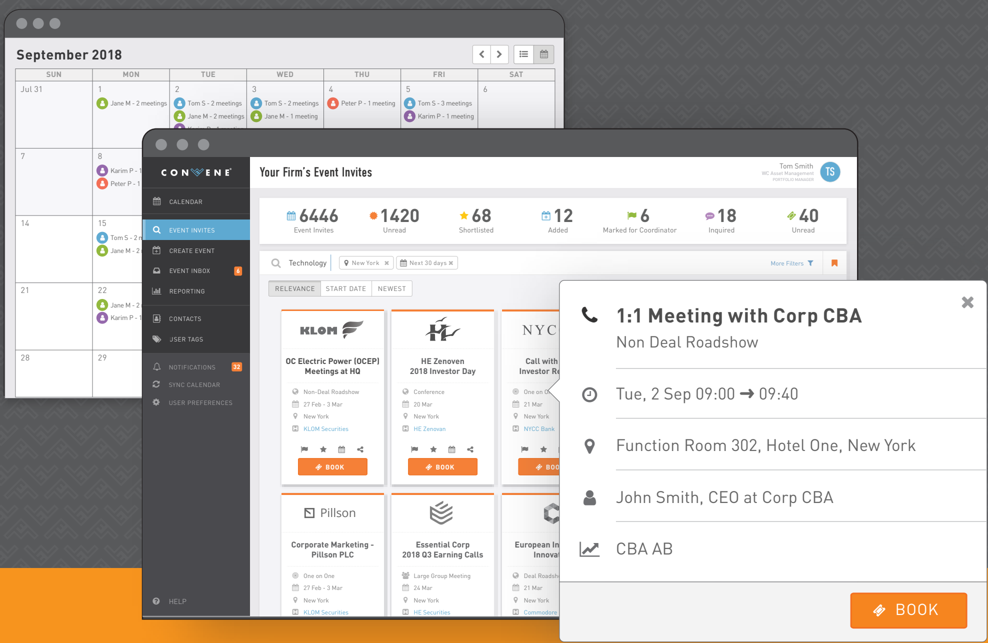
Almost uniquely, the provision of research and corporate access has existed for a long time in an environment where both client and service provider operate almost blissfully unaware of the supply and demand realities that would normally govern the prices of services. The advent of MiFID II is forcing firms to actually think about what they consume, whether it is useful in generating long-term alpha in portfolios, and how much that alpha may or may not be worth.

This is an extremely valuable process that will have a number of positive repercussions for how the industry operates but we are currently in the situation where MiFID II's long and winding development led many firms to adopt a wait-and-see position and predictably, waiting until the proverbial last minute is starting to create a sense of panic as firms start to recognize how much needs to be done in order to be ready in time. The image of the guy on the ladder in the hurricane comes back to mind.

Under this thinking, compliance is overshadowing the business impact of managing huge volumes of raw data on top of legacy systems. With this in mind, it is important for companies to take a step back from "panic mode" and look to MiFID II as an opportunity to fundamentally rewrite the way their research and corporate access is both tracked and priced so that it is transparent, efficient, and more effective for all concerned. Technology will be the enabler to achieving this outcome and the starting point for both sides to gain a true understanding of the cost and value of each service provided.

# ABOUT WECONVENE

WeConvene is a global, independently owned web-based platform that automates corporate access consumption and evaluation for the investment community. Events large and small directly impact investment strategies and WeConvene provides value to buy-side, sell-side and corporate organizations by enabling efficient discovery, booking and tracking of meetings.

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