WHAT'S THE INDUSTRY STANDARD FOR MANAGING RESEARCH PAYMENTS?

With only a few months to go before MiFID II kicks in, Q3 2017 saw something of a sea change in the stated approach of how leading global asset managers intend to manage research payments under the new regulations. As the deadline for implementation moves ever closer, **we are finally beginning to see an industry standard emerge.**

To recap, the industry has coalesced around two main approaches to dealing with MiFID II. The first was the use of Research Payment Accounts (RPA's) which allow the payment of research services out of client commissions but require a research budget to be set-up in advance and agreed upon by the asset manager and service provider. Once research budgets were satisfied, all trading would be done on an execution-only basis. This approach theoretically doesn't require much change from the way research and corporate access is currently provided but it will require far more stringent reporting requirements and importantly the ability to assign a value to every service consumed. The second approach is for the asset manager to pay for services out of their own pocket i.e. P&L. This method somewhat removes the need for the stringent reporting requirements but also means that payments need to be made out of operating costs, which will obviously result in reduced profit margins for the asset manager.

Until very recently, the stated position for the majority of asset managers was that they would take the RPA approach for MiFID II compliance but in September 2017 after Blackrock announced that all external research costs incurred for MiFID-impacted funds and client accounts will be paid for out of P&L, a number of global asset managers followed suit with similar announcements.[1]

Despite many of the asset managers that have publicly stated their policies on paying for third-party research, looking to adopt a dual approach - 1) Paying for research out of P&L for assets covered by MiFID II **but** 2) Charging research costs back to the fund (clients) where the assets are not covered by MiFID II, it is clear that taking the P&L route is quickly becoming the industry standard. Anyone involved in professional investing will by now be aware of MiFID II and this is certainly the case for asset-owners who will be reading the recent announcements from the leading asset managers in the industry on their plans to pay for research out of P&L and examining their asset managers who have not taken this approach. It is only natural that an asset owner would question an asset manager charging research payments back to the fund and ask why the asset manager is not bearing these costs when so many of their global peers have publicly stated they are. For many asset managers there is now a strong marketing argument for paying out of P&L even when MiFID II compliance isn't mandated as competition for assets will be against firms whose stated policy is to incur these costs internally. This will be particularly pertinent when the most influential fund consultants start to take MiFID II compliance into consideration when ranking funds for asset allocation. For the funds that are not paying for research out of P&L it could start to get a whole lot harder to get on a consultant's "buy list".

As paying for research out of P&L becomes the industry standard, what does this actually mean for research payments and how will it work?

Many asset managers have understandably vbeen focused on implementing a solution that results in the minimum disruption to operations and yet still allows them to comply with the regulations. This led to an initial focus on implementing processes and systems that help track every interaction with their service providers. But as we move into 2018, it will quickly become clear that for firm's paying for research out of their own P&L, spending time reviewing reams of data provided by their service providers in order to arrive at a bill for services consumed, is both unnecessary and not a sustainable long-term solution. The most likely process will involve the asset manager agreeing a fixed price up front for a range of services (each priced individually) and tracking spend in real-time. Typically that is how budgets work – agree a price, know the spend and then put the spend into a budget. Budgets don't usually work well in the rear-view mirror i.e. consume, evaluate and then figure out a payment level after the event, which is exactly why asset managers are quickly moving away from this approach.

1. https://www.reuters.com/article/us-mifid2-research-union-investment/union-invesco-schroders-janus-to-absorb-mifid-research-costs-idUSKCN1BQ1KW

One method that asset managers are already starting to implement is to provide their Portfolio Managers (PM's) and Analysts with their own assigned budget that they have discretion to spend on the services they both value and need. Until full industry wide price discovery emerges the more sophisticated firms will produce their own rate card for PM's and analysts to reference, with recommended prices for services based on benchmarking exercises that have been conducted internally.

As firms move through this process, the biggest long-term impact will be that individuals will apply a completely different mindset on the consumption of services when it is "their" money. The days where PM's and Analysts would consume services without regard to cost are gone and transparency in pricing will become mandatory.

The future pricing of services

With PM's and Analysts paying for specific services out of a defined budget, CFO's will begin to demand price discovery. Prices per meeting or per hour of an analyst's time will become a natural requirement. We are now at the very beginning of the price discovery process, the first step being the categorization of services and pricing method to be used. Many research providers have stated initial prices for their services but there is still some divergence both in terms of actual prices and how the services are packaged.

That said, the sell side and buy side are moving closer to a common position but we still expect it to be well into 2018 before an industry standard emerges on how each service will be priced. But it is clear to us, that as paying out of P&L becomes the primary method asset managers use to comply with the MiFID II regulations, a more transparent pricing model will be required, at which point the consumers of services (asset managers), can actually start to make accurate judgements on which service providers supply the most value. As we move to that point, we expect the model for pricing of services will start to look a lot like the below:

Service Category	Specific Service	Payment Type
Research Access	• Access to written research	• Annual fee charged to access research portal. • Fee will depend on the category of research accessed and number of individuals in the firm.
Research Services	• Access to analysts. • Custom research services.	• Analysts time charged on an hourly basis, similar to other professional service models such as lawyers. A package of analyst time may be • included within the annual subscription for general research access.
Corporate Access	• Meetings with corporates as part of Non-Deal Roadshows. • Bespoke trips. • Calls with Corporate Management. • Conference Attendance.	Payment provided for: • Bespoke trips organized by the sell-side. Based on expected number of hours invested by the organizer and level of insight provided. • Conference attendance. • Concierge fee paid for standalone meetings organized. • Payment will be differentiated for "basic" and "Marquee" events. access. No payment provided for: • Road shows associated with a security issuance paid for by the corporate issuer.

2018 and beyond

2017 has been a hectic year for asset managers needing to comply with MiFID II. The regulations cover pretty much every part of their operations and have required the implementation of processes and systems that ensure when January 3rd 2018 comes, they are adequately covered if the regulators knock on their door.

The starting point for the majority of firms was to make sure every interaction with their service providers could be tracked and they were capable of providing clear data on the services they have consumed. But for the firms that spent 2017 going through the hard work of quantifying and analyzing the operational changes required for MiFID II compliance, at the end of that process, the majority have realized the most sustainable route forward is to pay for research services out of their own P&L. There are two main implications of this move 1) The asset managers who are still looking to charge research payments back to the client are going to find it increasingly difficult to justify this approach to asset owners and 2) As this becomes industry standard, the model for pricing of services is going to quickly evolve and start to resemble any other market for services - upfront, transparent pricing for each unit of service consumed.

About WeConvene

WeConvene was founded in 2012 by former investment professionals and IT experts who made it their mission to address the costly, inefficient process of managing corporate access and analyst marketing events.

Want to learn more?

Don't hesitate to get in touch. You can email the team at sales@weconvene.com with your details and we'll get back to you as soon as possible. Alternatively please visit www.weconvene.com, or call:

New York: +1 (646) 846-5454
London: +44 800 802 1425
Hong Kong: +852 5808 9911